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Matters of Special Importance - 1997

Main Points

In this chapter each year, I highlight significant issues arising from our work of the year, and issues from previous years that continue to be of special importance. This year, I present issues that I consider to be of particular importance to the new Parliament elected last June.

The new Parliament faces a number of challenges and opportunities that stem from the changes unfolding in government:

- **Special attention is needed to maintain accountability in new service delivery structures.** An unprecedented movement of important public services away from government departments is under way. These new, but often more complex, arrangements can bring significant benefits, as long as accountability is not eroded.
- **The stresses facing the public service.** The public service is a vital institution under considerable stress. Parliamentarians can play an important role in ensuring that the steps being taken to renew the public service are adequate.
- **The continued need to carefully monitor the government's financial condition.** Although the deficit has been falling, the debt remains high by historic and international standards, making good information on the government's financial condition as vital as ever.
- **The importance of modernizing parliamentary scrutiny of the entire business of government.** The annual supply process focusses on only a limited portion of government expenditures. While information is improving, Parliament's ability to scrutinize the entire business of government needs to be strengthened.
- **The challenge of environmental and sustainable development issues.** The creation of the Commissioner of the Environment and Sustainable Development within our Office and the requirement for departmental sustainable development strategies are important new tools for moving from words to action.

Parliamentarians have available a number of instruments they can use to make a difference in how government is managed. However, their efforts have been hampered to a degree by the lack of proper information on plans and results. I am encouraged, though, by recent government efforts to address this long-standing concern.

Other recent and ongoing issues are discussed in a supplement to the chapter:

- The Year 2000 information technology problem is urgent, putting government programs and services at risk.

- Large information technology projects require that the Treasury Board Secretariat play a more active role.
- Moving government from a focus on inputs and process toward managing for results is possible, but it will take strong, persistent leadership.
- Government needs to improve its approach to privatization and commercialization initiatives by ensuring that fair market value is received for divestitures and that the results of each initiative are reported back to Parliament.
- It is time to make comptrollership a reality and improve the government's financial management capabilities.
- A number of opportunities for cost savings have been identified in our audits over the past year.
- Important progress has been made in protecting the tax base, but more remains to be done.
- There is a need to increase the momentum of efforts to maintain the sound ethical base in government.

Vision

We are committed to making a difference for the Canadian people by promoting, in all our work for Parliament, answerable, honest and productive government that reflects a commitment to sustainable development.

Mission

The Office of the Auditor General of Canada conducts independent audits and examinations that provide objective information, advice and assurance to Parliament. We promote accountability and best practices in government operations.

Elaboration of Mission

*In achieving our mission,
we want to make a difference by promoting:*

- ◆ *a fair and frank accounting of government's stewardship of financial and other resources*
- ◆ *efficiency and productivity in the public service*
- ◆ *cost effectiveness of government activities*
- ◆ *collection of revenues owed to the Crown.*

*Other effects we want to produce
through our work are:*

- ◆ *objective assurance on matters found to be satisfactory and unsatisfactory*
- ◆ *compliance with authority*
- ◆ *deterrence of fraud and dishonesty.*

Taking Government into the 21st Century: Matters of Special Importance for the New Parliament

The June election brought 90 new parliamentarians to Parliament Hill, and returned 211 with a new mandate. The members of this 36th Parliament will in all likelihood be those who lead government into the 21st century.

No doubt, parliamentarians are thinking a great deal about how to make a difference during this mandate. While much of their work rightly involves policy issues, much also involves monitoring the increasingly complex activities of government and holding the government to account. That is where my role comes in.

Our Office Is Here to Help Parliament

Popular culture in this country misses a critical element: important as my role as “watchdog” may be, it is Parliament that has the ultimate role of keeping watch over government. As Auditor General, my job is to alert Parliament to issues of how government is being managed, through timely, relevant, audit-based information. I and my staff are driven by the conviction that Canadians deserve government that delivers good value for money and serves their interests. In this way, we help Parliament in its job of holding the government to account.

One of my priorities as Auditor General has been to find ways to serve Parliament better. In addition to maintaining our long-standing and productive relationship with the Public Accounts Committee, we have worked extensively to bring our audit findings to the attention of other parliamentary committees. During the 35th Parliament, we appeared before 21 committees of the House and Senate in addition to the Public Accounts Committee. As well, we now release reports more than once annually, allowing us to report issues on a more timely basis.

Issues Facing the New Parliament

When I started my term as Auditor General almost seven years ago, I could not have imagined the extent and pace of change we now see in government. The scale of this unfolding change may well rival the fundamental restructuring of government during and after the Second World War, and the major expansion of government programs in the 1960s. As many have noted, the financial condition of governments, globalization, the information technology revolution and major demographic and societal shifts are among the factors behind the changes we are now experiencing.

The situation we face today is not unlike a business undergoing a major restructuring -- expanding into new lines of business and abandoning old ones, as it reorganizes internally and enters into new joint ventures. For shareholders of a business, a major restructuring brings real challenges and risks. The old

ways of keeping abreast of the company's fortunes often must change, and the issues on which shareholders must keep watch may become quite different.

Certainly, government is not a business and parliamentarians are not government's shareholders. All the same, I see similar challenges and opportunities for parliamentarians in the changes unfolding in government. Five issues are particularly important:

- the need to maintain accountability in new service delivery structures;
- the stresses facing the public service;
- the need to maintain careful monitoring of the government's financial condition;
- the importance of modernizing parliamentary scrutiny of the entire business of government; and
- the challenge of environmental and sustainable development issues.

Each of these issues has been, and will continue to be, given priority in our audits. Other recent and ongoing audit issues are presented in the supplement to this chapter.

Issue 1: Maintaining accountability as activities move outside traditional government structures

There is an unprecedented movement of activities -- many of which are key public services -- away from federal government departments. This is taking a variety of forms, under a variety of labels such as "devolution", "commercialization" and "alternative service delivery". For example, activities are being transferred to third parties, as in the case of the air navigation system, and to client groups, as in the case of Aboriginal programs. As well, new partnering arrangements are being negotiated to share program responsibilities with provincial governments.

As part of these changes, new organizations are being established that are structured much differently from the traditional model of a government department. This has the makings of a major change in the shape and nature of government. One notable impending change is the proposed Canada Customs and Revenue Agency. This would replace Revenue Canada, and alone would involve 40,000 employees -- some 20 percent of the federal public service -- and over \$2 billion in annual parliamentary appropriations.

Key Activities Being Transferred from Government Departments

NAV CANADA is a private, not-for-profit organization that assumed responsibility for the safe operation of Transport Canada's civil air navigation system in November 1996. Approximately 6,000 Transport Canada employees were transferred to the organization, which has announced revenues of \$776 million from its first 10 months of operation.

Canadian Food Inspection Agency is a separate agency reporting to the Minister of Agriculture and Agri-Food that consolidates the food inspection activities of Agriculture and Agri-Food Canada, Health Canada and Fisheries and Oceans. Over 4,500 full-time equivalents were transferred to the Agency, and it received annual parliamentary appropriations of \$271.8 million in 1997-98.

Canada Customs and Revenue Agency, as proposed, would replace Revenue Canada in administering Canada's revenue laws and those of participating provinces. The Agency would operate at greater distance from government and would involve the transfer of 40,000 employees and over \$2 billion in annual parliamentary appropriations.

Parliamentarians have an important oversight role to play in the establishment of these new organizations. Beyond the policy issue -- namely, whether the proposed structure is indeed the best option -- lies the issue of maintaining accountability. Many involve partnerships that demand more complex accountability arrangements between partners and back to their respective constituencies.

Proper accountability is critical for two reasons: the services being delivered frequently involve important matters of public interest, and in many cases the organizations will continue to require significant public funding.

Parliamentarians in the past have rightly asked how the fundamental principle of accountability to Parliament will be maintained in these new structures. Will parliamentarians continue to have a means by which to question ministers on these activities? How will Canadians and parliamentarians have assurance that the public interest is protected?

The new arrangements can bring important benefits, but proper attention must be paid to accountability. Proper attention is being paid in some cases to clearly delineating roles and responsibilities, establishing clear objectives, and requiring full and frank reporting of the results achieved -- key elements of good accountability. However, as experience elsewhere with the creation of new structures indicates, maintaining accountability has been a persistent challenge.

Without question, the accountability landscape is becoming more varied and less dominated by government departments. This and future Parliaments will need to develop effective mechanisms for holding to account a greater variety and number of organizations, involving more diverse relationships among Parliament, ministers and appointed officials.

For related audit work, see: 1997 Chapter 13 Health Canada - First Nations Health; 1997 Chapter 19 Transport Canada - Commercialization of the Air Navigation System; 1997 Chapter 20 Public Works and Government Services Canada - Privatization of the Canada Communication Group

Issue 2: The public service is an institution under stress

During the course of my career, I have come to believe that ultimately what makes an organization effective is not the quality of its administrative policies and procedures or its management systems. Important as these are, what matters most is the people who work there. Government organizations that are truly innovative, serve the interests of Canadians and deliver good value for money are those that have inspired leadership, strong values, and skilled and motivated people. There is no question in my mind that

a competent and professional public service is essential to the economic, social, environmental and political health of our nation.

Personnel Systems Are Getting in the Way

After years of on–again, off–again efforts to streamline government personnel systems, they still require:

- over 12,000 pages of rules and guidelines;
- 70,000 rules governing pay alone.

At the very time when we are facing significant challenges to keep, motivate, develop and attract good people, we have systems that are holding us back. Getting out from under these systems seems to be one reason behind the move to create new agencies.

Yet the results of our audit work suggest that the public service is an institution under considerable stress. Particular areas that need attention include rejuvenating and renewing the public service work force, and resolving long–standing human resource management issues that require legislative and administrative changes. These are not new issues: I and others have raised them in the past but insufficient action has been taken to resolve them. One of the real challenges in addressing these issues has been that central responsibility for them is shared among a number of bodies, including the Public Service Commission, the Treasury Board Secretariat and the Privy Council Office.

Many government officials, including the Clerk of the Privy Council, have expressed similar concerns about the condition of the public service. The Clerk has argued, “To perform well, the public sector must constantly retain, motivate and attract a corps of talented and dedicated public servants. There are indications that this could be the most difficult challenge that the Public Service of Canada will face over the coming years.” She has called this a “quiet crisis”.

The Clerk has initiated an exercise called *La Relève* to address these issues. Parliamentarians can play an important role in ensuring that the steps being taken will adequately address the many issues facing the public service. One means of doing this, as the House Standing Committee on Government Operations recommended in its Third Report tabled at the end of the last Parliament, is to regularly monitor the renewal process to ensure that progress is being made.

For related audit work, see: 1997 Chapter 1 Maintaining a Competent and Efficient Public Service; 1996 Chapter 5 The Reform of Classification and Job Evaluation in the Public Service

Issue 3: Monitoring the financial condition of government remains important

Amid a great deal of speculation about a coming “fiscal dividend”, it is important to pay close attention to the federal government’s financial condition. The numbers suggest that, while the battle over the deficit is close to being won, the debt remains a significant concern. The size of our debt in relation to the size of the economy remains high, both by historic standards and by comparison with other OECD countries. Progress on reducing the deficit has certainly been commendable, but it is no less important to focus on the government’s “financial condition” in the fullest sense of the term.

One unmistakable long-term challenge to government's financial condition is the aging of the Canadian population. The ratio of elderly to working-age Canadians is likely to rise sharply in the next few decades. While not all the elderly will be dependent on publicly funded pensions and services, many of them will be, putting pressure on government spending in areas of social security and health care. Our debt level and existing level of taxation put additional strain on our capacity to meet the unfolding demographic challenges without disadvantaging the young.

Good information is critical to fostering healthy debate about the public policy choices that lie ahead. The Canadian Institute of Chartered Accountants (CICA) recently completed a study that urged governments to report their financial condition through a set of 10 indicators. The CICA indicators cover three important dimensions of financial condition: the sustainability of the debt burden; a government's flexibility to raise revenues through taxation or borrowing, should it need to; and its vulnerability to forces beyond its control. The study demonstrates that financial condition involves more than just the government's financial position at a given time -- it requires taking the long view, which I recommended in this chapter in 1992.

By focussing attention on the sustainability, flexibility and vulnerability of the government's financial condition, I think the use of the CICA indicators can help us better understand the true state of the government's finances, and better debate the public policy choices we face as Canadians.

For related audit work, see: 1995 Chapter 9 Information for Parliament — Deficits and Debt: Understanding the Choices

Issue 4: Modernizing parliamentary scrutiny of the entire business of government

With the increasing complexity of the business of government in recent decades has come a greater variety of ways that money flows into and out of government. This brings the need to continue modernizing Parliament's ability to scrutinize and control the entire business of government.

The traditional foundation of Parliament's scrutiny of expenditures is the annual supply process. Yet annual appropriations have come to represent only the proverbial "tip of the iceberg" of government expenditures. Statutory expenditures, where moneys were approved under previous legislative authority and hence are not voted in the annual supply process, account for 66 percent of federal spending (\$106 billion in 1996-97), leaving only 34 percent (\$55 billion in 1996-97) that is voted annually. Other important, but less obvious, flows of money include tax expenditures (estimated to be in the tens of billions of dollars annually), vote-netted program funding and the government's growing reliance on user charges.

The Growing Use of User Charges

To deal with fiscal restraint, government is bringing in a number of new user charges, revenues from which totalled \$3.8 billion in 1995-96.

Recent audits by our Office have highlighted weaknesses in the implementation of user charges. For example, we have found that government accounting systems are typically not designed to provide costing information needed to justify the levels of user fees charged.

The move toward greater cost recovery raises important questions for Parliament. Have departments minimized their costs before asking users to pay? Have the financial, competitive and socio-economic impacts of user charges, in both the short and long terms, been considered? Are there proper redress mechanisms for stakeholders?

And perhaps most important for parliamentarians: does Parliament have the information it needs to keep an eye on this issue?

Concern about the challenge this poses to parliamentary control and scrutiny is hardly new: it has been noted on a number of occasions by our Office and others.

These issues are particularly timely given the release at the end of the last Parliament of the Sixty-Fourth Report of the Standing Committee on Procedure and House Affairs, entitled *The Business of Supply: Completing the Circle of Control*. As the Committee noted, some significant advances have been made in the tools and information available to help Parliament scrutinize these various revenues and expenditures - a topic that I discuss in more detail below.

The report makes a series of recommendations for further enhancing the information available to Parliament on expenditures outside annual appropriations, and for strengthening the ability of Parliament to scrutinize these regularly. Particularly noteworthy were the Committee's recommendations that statutory and tax expenditures be explicitly subject to cyclical parliamentary review. The Committee also called for strengthening the program evaluation of statutory expenditures, similar to recommendations I have made in the past. These suggestions deserve serious consideration by the new Parliament.

Bringing these various flows of money under formal, recurring parliamentary review would be a major step in strengthening the role Parliament plays in holding government to account.

For related audit work, see: 1997 Chapter 5 Reporting Performance in the Expenditure Management System; 1996 Chapter 3 Evaluation in the Federal Government; 1995 Chapter 24 Revolving Funds in the Parliamentary System: Financial Management, Accountability and Audit

Issue 5: Sustainable development -- moving from words to action

Soon after becoming Auditor General in 1991, I identified the environment as one of the key issues on which I planned to focus. Environmental and sustainable development matters will shape not only our immediate future but also our legacy to future Canadians. Our challenge is to go beyond the rhetoric of sustainable development, and to focus on its practical implementation.

In the years since, our capacity to deal with environmental and sustainable development issues has increased substantially. In 1995, the 35th Parliament amended the *Auditor General Act* to provide parliamentarians and the public with a new set of tools to assess the federal government's performance in managing environmental and sustainable development issues:

- “Environment” joins economy, efficiency and effectiveness as the fourth “E” that our Office considers in deciding what to report to the House of Commons.
- Twenty–four federal government departments and agencies are required to prepare sustainable development strategies and table them in the House of Commons by 15 December 1997.
- The position of Commissioner of the Environment and Sustainable Development was created within our Office with the mandate to review and report on departments’ sustainable development strategies, and on other issues that should be brought to the attention of Parliament.

The Atlantic Fisheries Crisis: Why Sustainable Development Matters

A simple truth lies at the heart of the concept of sustainable development: something imbalanced cannot continue indefinitely. The Atlantic fisheries crisis provides a compelling illustration of what happens when government programs are unable to achieve a result that is sustainable from an environmental, social and economic perspective.

Chapters 14 through 16 of the April/October Report detail how over \$3 billion, including \$1.9 billion under The Atlantic Groundfish Strategy, has been spent in the last seven years in an attempt to solve the problems of the Atlantic groundfish fisheries. Little progress has been made, however, toward reducing fishing overcapacity. As well, too many people remain dependent on the fisheries -- if anything, The Atlantic Groundfish Strategy may well have had the reverse effect of encouraging people to remain attached to the fishery and dependent on federal government support. And, while improvements have been made to certain fishery management activities, more needs to be done to ensure conservation of the Atlantic groundfish stocks.

Billions of dollars later, the story remains one of too many boats, too many people dependent on the groundfish fishery, and far too few fish. It is a situation that clearly seems unsustainable.

The Commissioner presented his first report to Parliament in March of this year. The report highlighted three key concerns about the federal government’s environmental performance over the past decade: an implementation gap, where the federal government’s performance has tended to fall short of its stated objectives; a lack of co–ordination and integration among government departments and between jurisdictions; and inadequate performance review and related information to Parliament.

How we together make use of the new tools for assessing government’s performance will send a powerful signal to departments and to the public of the importance attached to this policy area, and of our capacity to turn good intentions into effective action.

For related information, see: 1997 Report of the Commissioner of the Environment and Sustainable Development; 1997 Chapter 4 Control of the Transboundary Movement of Hazardous Waste; 1997 Chapter 10 Natural Resources Canada — Energy Efficiency; 1997 Chapter 14 Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish; 1997 Chapter 15 Fisheries and Oceans Canada — Rationalization and Renewal: Atlantic Groundfish; 1997 Chapter 16 Human Resources Development Canada — The Atlantic Groundfish Strategy; 1997 Chapter 24 Agriculture and Agri–Food Canada - Prairie Farm Rehabilitation Administration; 1997 Chapter 27 Ozone Layer Protection: The Unfinished Journey; 1997 Chapter 28 Fisheries and Oceans - Pacific Salmon Management: The Sustainability of the Resource Base; Chapter 37 Office of the Auditor General Sustainable Development Strategy

Instruments for Making a Difference

Parliamentarians have a variety of means available to make their mark on the management of government. The legislative process is one such opportunity: when a new program is introduced, parliamentarians can pursue the issue of whether the government organizations involved have the capability and resources to implement the proposed legislation. Another opportunity lies in the ability of committees to launch hearings on any aspect of government management in their subject matter area.

The Atlantic Fisheries Crisis: Why Performance Reporting Matters

The limited success of programs to deal with the problems of the Atlantic groundfish fisheries serves to illustrate a broader question: how are parliamentarians to know whether government programs are indeed working?

All too often, Parliament's only sources of information have been media reports, think tank studies, contacts with interest groups and constituents, internal government studies released under Access to Information requests, or our audit reports.

Valuable as these are, they are no substitute for the information that government is obliged to provide to Parliament for accountability purposes. Taking The Atlantic Groundfish Strategy as an example, it seems entirely reasonable to expect that \$1.9 billion would not be spent without accounting to Parliament for what was achieved and what lessons can be drawn for future programs. In fact, little information on the results of the strategy has been provided.

Program evaluations, good reporting on performance, and the like will not themselves solve complex problems, such as those facing the Atlantic fisheries. But they are essential tools in a first step toward finding solutions -- understanding the true nature and extent of the problem and whether existing approaches are working.

Potentially one of the best opportunities for committees to scrutinize government management is one of the oldest -- parliamentary review of the government's annual Estimates. For a number of reasons, it also has been a much underused opportunity. As the Sixty-Fourth Report of the Standing Committee on Procedure and House Affairs concluded earlier this year, "The inadequacy of committee study of the Estimates has become depressingly obvious." The report provided a number of thoughtful suggestions on ways by which Parliament could make more effective use of the Estimates process.

I have long argued that one thing hampering parliamentarians from making better use of the Estimates process has been that government has not provided them with appropriate information. Given the many competing demands on their time and considering the size and complexity of government, parliamentarians need information, tailored to their needs, that clearly and concisely explains what departments plan to do, what it will cost, what results they hope to achieve, and what results they actually have achieved. The lack of information on results has been a chronic problem, one that I have highlighted repeatedly.

As part of efforts to revise its Expenditure Management System, the government has been actively experimenting with ways to improve the information reported to parliamentarians. I have been supportive of these changes and was pleased to see the Improved Reporting to Parliament Project, after a successful pilot phase, extended to all departments this fall.

But better information is only one element in making the Estimates process more useful to parliamentarians. As the Procedure and House Affairs Committee report suggested, a more vexing issue has been how, in our system of strong Cabinet government, parliamentarians can see an opportunity in the Estimates process to influence government decisions. The reforms of the Expenditure Management System have tackled this by requiring departmental performance reports to be tabled in the fall, in time for committees to influence the direction of the following spring's Budget decisions and supply requests, and departmental plans to be tabled in the spring, in time for committees to influence Cabinet's summer deliberations on priorities.

It is now up to parliamentarians to signal whether the information being provided meets their needs. If they press for information on the results of government activities and visibly use the information in their work, they will give departments a powerful incentive to collect and report the information.

It might be appropriate to make these requirements a permanent feature in the supply process. This could take a variety of forms, including that of accountability legislation requiring departments to report on their performance, as other jurisdictions such as the United States, New Zealand, Western Australia and Alberta have enacted.

As parliamentarians make greater use of performance information, they may find it useful to have our Office provide some form of assurance on the fairness and reliability of the information reported by departments. I will be providing such an assessment annually on the performance reports of the new Canadian Food Inspection Agency.

For related information, see: 1997 Chapter 5 Reporting Performance in the Expenditure Management System; 1997 Chapter 11 Moving toward Managing for Results; 1997 Chapter 14 Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish; 1997 Chapter 15 Fisheries and Oceans Canada — Rationalization and Renewal: Atlantic Groundfish; 1997 Chapter 16 Human Resources Development Canada — The Atlantic Groundfish Strategy

Conclusion

Parliamentarians have a number of important roles to play in overseeing the changes under way in government -- as advocates for better government programs and better quality of service, as protectors of accountability to Parliament and the Canadian public, and as guardians of the public interest and the public purse.

My Priorities are:

1. To help improve the government's financial condition, by:
 - supplying useful information and encouraging government to follow suit;
 - fostering improvements in the effectiveness of revenue programs; and
 - finding savings in government operations.

2. To stimulate real advances in accountability concepts and improve accountability practices in government.
3. To influence the quality of financial management in government.
4. To contribute to necessary changes in the public service.
5. To implement fully the role of the Commissioner of the Environment and Sustainable Development.

The members of the 36th Parliament are probably the last with whom I will deal as Auditor General. Indeed, with my 10-year term ending in 2001, our mandates will likely end at about the same time. I have set five priorities where I want to see this Office make a difference between now and 2001. As I pursue these and other issues, I hope to have solid working relations with parliamentarians and standing committees.

These are challenging times for all of us. Indeed, I can think of few other times when there has been as much opportunity to make a difference in public administration or when it has been more important to maintain the strength of our national institutions.

It is up to each of us to seize the opportunity before us and leave a lasting mark. We need to be mindful of the impact of our actions now and in the years to come. By our decisions, we will take Canada into the 21st century.

Chapter Supplement: Other Recent and Ongoing Audit Issues

The Year 2000 Problem Looms Large

I have become increasingly concerned about the threat that the “Year 2000” problem poses to the government computer systems on which we rely so heavily. Because of a two–digit coding practice that was prevalent in the past, systems that are not changed in time may malfunction or fail as they approach the year 2000.

Chapter 12 of the April/October 1997 Report examines risks and exposures that the government faces as a result of the Year 2000 threat. We concluded that, at the time of the audit, the rate of progress had been generally slow, which means that many important systems may not be fixed in time. I am very concerned that government programs and services are at risk.

The year 2000 is approaching fast. We must assign top priority to Year 2000 projects and step up the pace. The work is laborious and other priorities may have to give way. Success lies in securing and sustaining senior management commitment and support. Ministers and members of Parliament can help by serving as champions for Year 2000 efforts in government and by lending support to senior management in resolving roadblocks as they arise.

For related audit work, see 1997 Chapter 12 Information Technology: Preparedness for Year 2000

Information Technology Needs an Active Treasury Board Secretariat

For a number of years, we have expressed concern that significant risks are not being managed properly in large information technology projects. We estimate that projects planned or under way may well cost more than \$5 billion. All but a few of the projects we have audited lacked sound project management and effective risk management, resulting in instances of large budget overruns, significant delays, unacceptable results and the occasional project failure.

As a general rule, I think that government departments, many of which are among the largest organizations in this country, should be capable of managing their own affairs. In some areas, such as human resource management, they are unnecessarily hampered by restrictive central government controls.

Still, large information technology projects are an exception: not all departments can be expected to have the specialized skills needed to manage these complex, high–risk projects. I think the Treasury Board Secretariat needs to play a more active role in these projects after funding approval, by monitoring their status more closely and advising ministers of the Treasury Board when project risks are unacceptable.

There is a need to clarify and review the role of the Secretariat in information technology and in other areas where it has responsibilities. Indeed, the Secretariat itself has been reassessing its overall role and approach. Parliamentarians and other stakeholders should be involved in these deliberations because of the significant effect these could have on government administration and accountability.

For related audit work, see: 1997 Chapter 23 Systems under Development: Taking Charge; 1996 Chapter 16 Treasury Board Secretariat — Renewing Government Services Using Information Technology; 1996 Chapter 24 Systems under Development — Getting Results

Moving the Focus from Inputs and Process toward Results

The new Expenditure Management System -- as well as other recent federal government management initiatives -- is built on the idea that departments should set clear program performance goals, measure and report performance, and then use that information to make programs work better. In short, it means putting more emphasis on results. It is hardly a new idea, but only in recent years has it received a great deal of attention in government, here and in other countries.

These government initiatives will succeed only if results become the focal point of what departments do, from the level of day-to-day operations on up. Results cannot be the concern of only the planners and program evaluators. This is one of the key lessons we found this year when we examined federal government organizations that have successfully adopted a focus on results.

In these organizations, one major hurdle turned out to be the significant cultural change needed, not technical issues of measuring program outcomes. Over the years, managers have been held accountable mainly for inputs and process. Changing age-old practices and incentives takes time and strong, persistent leadership.

I am encouraged when I hear deputy ministers talking more and more about moving their organizations toward a focus on results. Federal government organizations have a long way to go, but experience here and elsewhere shows that it can be done and that it works.

For related audit work, see: 1997 Chapter 5 Reporting Performance in the Expenditure Management System; 1997 Chapter 11 Moving toward Managing for Results

Reducing the Risks in Privatization and Commercialization

There is a worldwide trend among governments to transfer more and more activities to the private sector. In the Canadian context, the recent sale of the Canada Communication Group (CCG) and the commercialization of the air navigation system are important examples we audited this year. These two initiatives, along with experiences in other countries, offer critical lessons for future privatization and commercialization efforts.

Perhaps one of the most valuable lessons is the need to set up a rigorous and systematic method by which to ensure that appropriate market value is received for the entity transferred. From my private sector experience, I believe the best way to do this is by requiring formal valuations by independent financial advisors and ensuring that the transactions are well documented. Such a process in the public sector would, I think, better protect the interests of the taxpayer and the government itself.

International experience shows, and the CCG initiative illustrates, that the inherent risks in divestitures are lessened when the process is done in two phases. In a two-phase approach, the operation to be transferred is first carved out of government operations and set up as a government-owned entity.

The initiatives offer one further important lesson — the need for transparency in the transactions and for accountability to Parliament. Currently, the government is not required to report back to Parliament on the results of each divestiture, including a complete picture of the costs and proceeds of the transaction. Our audits of these initiatives demonstrate that this is clearly needed.

For related audit work, see: 1997 Chapter 19 Transport Canada - The Commercialization of the Air Navigation System; 1997 Chapter 20 Public Works and Government Services Canada - Privatization of the Canada Communication Group

An Opportunity to Make Comptrollership a Reality

Financial management plays a critical role in contributing to the government's goals of reducing costs and improving its financial position. Despite numerous initiatives that have tried to improve financial management capabilities in the last 25 years, progress remains slow. For example, government officials readily acknowledge that existing financial systems are deficient in many respects. And, as a number of this year's audits note, decision makers are often unable to assess the financial consequences of their decisions.

More than ever, comptrollership needs to be a significant part of the job of every manager. Comptrollership involves more than bookkeeping, or even financial management. In particular, it requires the ability to link costs incurred to results achieved, which is a fundamental part of business planning and performance reporting in the revised Expenditure Management System.

In October of this year, the report of the Independent Review Panel on Modernization of Comptrollership in the Government of Canada was released. We agree with the Panel on the need to strengthen comptrollership, and believe the report gives the government a good opportunity to address this long-standing concern. To do this, ongoing support from the top -- at both the political and bureaucratic levels -- is needed. Without it, only marginal technical improvement in financial management and comptrollership can be achieved. Ultimately, stronger capabilities will never be put in place if ministers and deputy heads do not demand them.

For related audit work, see: 1997 Chapter 2 Financial Management: Developing a Capability Model; 1997 Chapter 3 Management of the Government's Accounting Function: A Central Agency Perspective; 1997 Chapter 9 Foreign Affairs and International Trade Canada - Financial Management and Control; 1997 Chapter 31 Revenue Canada - The Financial Management Regime

Opportunities for Cost Savings

This year, as in past years, we have reported on several areas where departments could achieve cost savings. This year we noted several examples:

- The *Report on the Federal Court of Canada and the Tax Court of Canada* in April identified a series of needed improvements that could yield savings of 15 to 25 percent out of about \$53 million spent annually to support the judicial function of the courts.
- In Chapter 21 Household Goods Removal Services of the Federal Government, we identified the potential to save \$1.5 million out of the \$5 million spent annually in the government's administration of household goods removal.
- In Chapter 31 Revenue Canada - The Financial Management Regime, we identified opportunities to generate several millions in potential interest revenue for the government each year by depositing taxpayer receipts more promptly.

As well, a number of our audits identify opportunities to reduce expenditures or use existing resources more effectively that cannot easily be quantified. For example, in Chapter 6 Contracting Performance, we concluded that there is much room to improve government contracting to get better value from government contract expenditures, which totalled over \$14 billion in 1995-96.

In Chapter 12 Information Technology: Preparedness for Year 2000, we noted that if the Year 2000 problems are not addressed on an urgent basis, the government faces the risk of significant cost escalation as well as systems errors or failures.

Our audits of information technology systems under development continue to identify potentially significant cost savings by improving management practices. This year, in Chapter 23 Systems under Development: Taking Charge, we found that practices for in-house projects need to be improved to reduce the risk of project delays and cost overruns.

Protecting the Tax Base

We cannot overestimate the importance of protecting the tax base, which provides the revenues needed to pay for government services. Parliamentarians in the past have encouraged us to maintain taxation audit work as one of our priorities.

This year we followed up on past observations and found the results to be very encouraging. We believe that the many changes to systems, procedures and practices we observed have strengthened tax administration. Some examples:

- Income tax advance rulings and GST rulings and interpretations are more widely available.
- Collection of unpaid income tax, GST, excise tax and customs duty is better integrated, more proactive and based increasingly on an assessment of the risk of loss.
- More and better data are available to help find those who have failed to file income tax returns or to register for the GST.
- Some significant technical deficiencies in the *Income Tax Act* have been corrected.

Together, these and other improvements strengthen the tax base and enhance the fairness of the tax system. Even so, challenges remain:

- Improving the ability to monitor and evaluate the performance of the processing system for individual income tax returns.
- Improving the verification of RRSP contributions.
- Improving certain bookkeeping procedures.

We feel strongly that these matters should be dealt with, and we are confident about the ability of Revenue Canada to address them.

For related audit work, see 1997 Chapter 18 Revenue Canada and Department of Finance -- Fostering Improvements in Tax and Trade Administration: Follow-up of Previous Audits

Ethics in Government

One fundamental value that underpins democracy is honesty in government. Our Office has had a special role in upholding this value since the early days of Confederation. While I believe that Canadian governments compare favourably with most other countries in their integrity, this does not mean we can relax. Probity in government requires effective financial and management controls, but it ultimately rests on the ethics of individuals and a management infrastructure that supports sound ethics.

While the findings of our May 1995 chapter on ethics and fraud awareness were positive overall, the report did show the need for action to maintain the sound ethical base. We suggested an ethics framework that focussed on a statement of principles, leadership, empowerment of public servants to act in the public interest, transparency in government decision making, ethics-related training, and a mechanism for discussing and reporting ethical concerns.

Following this, the Clerk of the Privy Council established a Task Force on Values and Ethics in the Public Service, which advocated an ethics regime similar to the one proposed in our audit. The Clerk has also emphasized the importance of honesty and integrity in her most recent reports to the Prime Minister on the public service. As well, the *Lobbyist Registration Act* has been strengthened to require public disclosure of information on who is attempting to influence government policy.

I believe there is a need to increase the momentum of these efforts to maintain probity in government. To contribute to such efforts, our Office will conduct a review of government responses to our May 1995 chapter as well as to the report of the Task Force. We also plan to conduct reviews of specific elements of the ethics framework we suggested.

For related audit work, see: 1995 Chapter 1 Ethics and Fraud Awareness in Government

April 1997

Foreword and Main Points

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**Report of the Auditor General
to the House of Commons
for April 1997**

Foreword

I am pleased to present the April volume of my 1997 Report. Bound with this Foreword are the Main Points of 10 chapters, which are issued separately:

1. Maintaining a Competent and Efficient Public Service
2. Financial Management: Developing a Capability Model
3. Management of the Government's Accounting Function: A Central Agency Perspective
4. Control of the Transboundary Movement of Hazardous Waste
5. Reporting Performance in the Expenditure Management System
6. Contracting Performance
7. Acquisition Cards
8. Department of Finance -- Equalization Program
9. Foreign Affairs and International Trade Canada -- Financial Management and Control
10. Natural Resources Canada -- Energy Efficiency

Ongoing change has become a permanent feature of the federal government as it continues to seek more efficient, economical and effective ways of delivering programs and services to Canadians. The effects of recent downsizing and budget cuts are still being felt, even as public servants engage in re-engineering and redesigning the way they must work in the future to be able to adjust to new realities.

Part of this redesign involves changes to the basic infrastructure for accountability in the federal government. Several chapters in this Report reflect ongoing work by this Office to help ensure that in its changes the government "gets the fundamentals right." Studies reported here will serve as a foundation for much of the audit work we plan to carry out in the months ahead.

In particular, the government's use of alternative, market-like mechanisms to deliver services is increasing at the same time as many of the rigid rules and procedures of the past are being eliminated. This makes it more critical than ever that decision makers have the right information at the right time. The Report highlights the need to improve the quality of information for

financial management and to modernize the systems that produce it. Cost awareness and an attitude of stewardship for resources need to be encouraged at all levels.

The Report also stresses the need for senior managers to know and state more clearly what they expect their programs and activities to achieve, and to measure and report in more concrete terms the results they attribute to those efforts. Knowing where resources have had the desired effect -- and where they have not -- will enable decision makers to continue successful activities or make the necessary adjustments to provide Canadian taxpayers with the best value for their money.

Maintaining a Competent and Efficient Public Service

Assistant Auditor General: Maria Barrados

Responsible Authors: Alick Andrews and Otto Brodtrick

Chapter 1 - Main Points

1.1 The public service's effectiveness, and the efficiency with which it carries out its functions, are crucial to the quality of governance and to the economic, social and political health of the country.

1.2 About 500,000 men and women have some form of employment in the federal public sector; about 207,000 of those constituted the traditional public service as of March 1996. The federal public service is an institution under pressure to change and adapt: pressure from Canadians, the economic-political environment, and advocates of management reform. All participants in our study were convinced of the importance of building on the strengths of the past to ensure that Canada enters the twenty-first century with a modern, world-class public service.

1.3 Particular attention needs to be given to renewing and rejuvenating the public service work force; resolving long-standing human resource management issues; establishing a more constructive dialogue on performance and partnership; and continuity of leadership and persistence in moving forward.

1.4 The public service faces the challenge of identifying and filling the gaps resulting from recent departures, as well as building the human resource capacity to meet new challenges and provide for a strong public service in the future. Problems with three of the important personnel systems need to be addressed. Various attempts have been made to modernize them but more needs to be done.

1.5 Improved ways of dealing with shortfalls in administrative performance need to be found. An effective public service needs a Parliament and media that can fairly discuss errors in the context of overall performance.

1.6 Persistent and ongoing effort is required to address these challenges. Further discussion and debate are required on the future size and tasks of the public service and on the organizational approach to take.

Financial Management: Developing a Capability Model

Assistant Auditor General: Douglas G. Timmins
Responsible Auditor: Hugh A. McRoberts

Chapter 2 - Main Points

2.1 The environment within which the government is operating today is rapidly changing. The effects of limited resources, downsizing and delayering are placing greater demands on the government in providing services to Canadian taxpayers. Within this environment, the need for effective financial management has never been greater. Financial management plays a critical role in contributing to the government's achievement of its goals of reducing its costs and improving its financial position.

2.2 Despite the number of royal commissions, audits, studies and Treasury Board Secretariat initiatives over the years, achieving effective financial management in government organizations remains, in our view, a top priority that requires ongoing attention. With each Report of the Auditor General, we continue to observe and report to Parliament on significant problems, across a broad range of government operations, that occur as a consequence of failings in financial management.

2.3 These issues represent, in our view, a continuing basis of concern and raise important questions about the state of financial management in the government. Not the least of these is the question of whether our observations represent the type of failings that result from doing business in any large organization, or are symptomatic of more systemic problems in financial management. Additionally, some ministers continue to express to our Office their concern and frustration over the lack of appropriate financial information to support strategic decision making.

2.4 The Office of the Auditor General has had, as a long-standing strategic priority, the goals of encouraging better financial management within the federal government and improving the understanding of the role that financial management can and should play. It is for this reason that, in conjunction with the Treasury Board Secretariat, we have initiated this study. The objective of this study is to build on existing work to develop a modern framework that will describe key elements needed for effective financial management and that will provide a basis for assessing the state of financial management within departments and agencies.

2.5 This chapter is the first stage of a study designed to respond to the need for a revitalized financial management framework. It is intended to provide a basis for discussion among central agencies, departments and our Office. Once complete, the study will provide an agreed-upon framework to assess financial management capabilities and to improve the effectiveness of financial management in the federal government.

2.6 We are very encouraged by the recent initiative of the President of the Treasury Board in establishing an Independent Review Panel on Modernization of Comptrollership in the Government of Canada. The Office supports the work of the Panel, and we will take the results of its work into account as this study proceeds.

Management of the Government's Accounting Function: A Central Agency Perspective

Assistant Auditor General: Ron Thompson

Responsible Auditor: John Hodgins

Chapter 3 - Main Points

3.1 The accounting function provides essential information for managing the government and for reporting financial results to Parliament, Canadians and other interested parties.

3.2 Although the accounting systems are out-of-date technically, they continue to produce annual financial statements for the government that are credible, understandable and useful. In fact, in the past decade the function has undergone significant improvements and efficiencies that have, among other things, placed Canada at the forefront internationally in this type of reporting.

3.3 However, the ability of the accounting function to analyze and interpret financial information throughout the year needs to be strengthened in order to forecast financial results of that year and budget figures for the following year.

3.4 In response to these needs, the government is making extensive changes to its accounting function by implementing a Financial Information Strategy. The Strategy should help modernize and strengthen the accounting function. While we agree with the changes being undertaken through the Strategy, we believe that more is needed.

3.5 Specifically, we believe that the government should prepare and publish its financial reports in a more timely fashion, and consider other strategies to enhance the usefulness and credibility of its monthly or quarterly reports.

3.6 In view of the significant changes under way and planned, we continue to believe that the government should amalgamate its central accounting function and take immediate steps to assess the capability of accounting groups within departments and agencies to implement new systems and accrual accounting.

3.7 The government has established an Independent Panel on Modernizing Comptrollership in the Government of Canada. The Panel may wish to consider our findings and recommendations as part of its work.

Control of the Transboundary Movement of Hazardous Waste

*Commissioner of the Environment and Sustainable Development: Brian Emmett
Responsible Auditors: Dan Rubenstein or Wayne Cluskey*

Chapter 4 - Main Points

- 4.1** The primary objective of this audit was to determine whether Environment Canada, in co-ordination with other federal departments and the provinces, has established an effective and comprehensive regime to control the transboundary movement of hazardous waste consistent with Canada's international commitments.
- 4.2** Environment Canada has made a good start in establishing an effective and comprehensive regime to control transboundary movements of hazardous waste, but there are still some significant deficiencies. For example, Environment Canada has yet to establish the required capacity for proactive prevention of illegal shipments of hazardous waste. At the border, there is limited enforcement action directed to detecting illegal traffic in hazardous waste.
- 4.3** Canada has an obligation, under international agreements it has signed, to control the exports and imports of hazardous wastes. Revenue Canada Customs Border Services does have an infrastructure to monitor imports on an ongoing basis, but it is not operationally set up to physically control individual export shipments.
- 4.4** There are real monetary incentives for illegal traffic. For example, the cost of processing a legal truckload of hazardous waste can range from \$300 to \$1,200 a tonne.
- 4.5** There is limited chance of detecting illegal traffic in hazardous waste at the border; inspection and effective testing of samples of potentially illegal imports and exports are limited. Moreover, there is an even lower chance of detecting illegal shipments of hazardous wastes at marine ports or railyards.
- 4.6** In an area such as controlling the transboundary movement of hazardous waste, the chain is only as strong as the weakest link. In our opinion, as a result of the significant gaps in the areas of prevention, detection and enforcement and the limited facilities to physically control exports of hazardous waste at the border, Canada is not in a position to know the extent to which it is living up to its international obligations with regard to preventing illegal traffic at the border.

Reporting Performance in the Expenditure Management System

Assistant Auditor General: Maria Barrados

Responsible Auditor: John Mayne

Chapter 5 - Main Points

5.1 Information on how well programs are doing is needed to make informed decisions on how to spend tax dollars and improve programs, and to demonstrate to Parliament and Canadians what they are getting for their taxes. Often, neither the public nor members of Parliament, or managers, have this information. The focus has too often been on describing the services delivered, rather than their results.

5.2 The federal government is in the process of revamping its Expenditure Management System, the process by which it plans, budgets and seeks parliamentary approval of future expenditures. The changes create an incentive for departments to develop better information that helps managers provide more effective programs to Canadians and inform Parliament in a more timely way about the results of their activities. Some Canadian provinces and governments abroad have already made important strides toward providing their legislatures and citizens with better information about the performance of government programs.

5.3 Progress has been made by several departments, and we found instances in which performance information reported to Parliament addressed many key aspects of performance reporting. In particular, we found improvement in the information's orientation to results. But to fully realize the potential, departments need to describe expected performance more clearly and concretely — that is, in more measurable terms. The account they give of performance needs to focus more on the benefits for Canadians. This will take time.

5.4 Further progress requires strong leadership by the Treasury Board Secretariat and senior departmental managers. The Treasury Board Secretariat has implemented positive innovations in a short period of time, but needs to improve the consistency of the assistance it provides to departments as well as its efforts to document and communicate good practices in measuring and reporting performance.

5.5 The role of parliamentary standing committees is vital to continued progress. If committees ask for information on the results of government activities and visibly use the information in their deliberations, departments will have a powerful incentive to collect and report the information.

Contracting Performance

Assistant Auditor General: Shahid Minto

Responsible Auditor: Michael Weir

Chapter 6 - Main Points

6.1 In 1995-96 the government paid outside suppliers about \$14.3 billion (goods, services and construction), which included 6 million separate purchases affecting thousands of responsibility centre managers and suppliers, through 93 departments and agencies and 2,000 procurement experts.

6.2 Canada's treaty partners, businesses, appointed and elected officials and its citizens all define "good contracting performance" differently. The contracting process has become increasingly complex.

6.3 On the basis of our examination it appears that, while there is much to build on, there is a lot of room to improve the government's contracting performance. The conclusions we have reached are sufficiently serious, and the problems sufficiently widespread and long-standing, to warrant greater top-level attention to contracting than it has received in recent years.

6.4 Some aspects of performance have degraded over time, and others have remained below expectations for decades. Treasury Board has not established baselines despite the multiplicity of conflicting objectives.

6.5 Constraints to better contracting (and to more honest reporting about contracting performance) are complex, long-standing and deeply embedded. Because of the nature of the constraints, the variations among individual departments, and the changing environment of government contracting, the potential for improvement is not uniform among departments (and even within them) or across different categories of goods and services.

6.6 The Treasury Board and Public Works and Government Services Canada have put in place important elements of a framework to support greater departmental autonomy in contracting. Overall, however, much remains to be done to see that these objectives are understood, accepted and realized in practice.

6.7 To maintain effective overall control over increasingly delegated contracting activities, delegation needs to be supported by more effective functional direction and improved visibility for results and decisions. Treasury Board Secretariat needs to:

- explore better ways of managing long-standing tensions among the responsibilities, expectations and authority of individuals and organizations; and

- periodically provide Parliament with a better overall strategic assessment of contracting performance and priorities, showing the progress made toward agreed objectives.

6.8 Public Works and Government Services Canada can assist by providing functional advice and expertise to other departments. It also needs to ensure that contracting information provided to Treasury Board Secretariat and other stakeholders is timely, credible and free of material error.

Acquisition Cards

Assistant Auditor General: Shahid Minto

Responsible Auditor: Trevor R. Shaw

Chapter 7 - Main Points

7.1 Acquisition cards are a recent instrument of purchase in the federal government. The use of cards has grown rapidly since 1991 and continues to grow. During 1996, approximately 20,000 cards were used to acquire \$172 million of goods and services.

7.2 The use of cards has made it difficult to apply traditional financial controls, such as segregation of duties. Essential control cannot be achieved if organizations do not monitor and analyze cards, record and match charges, and carry out periodic audits and verifications of card transactions. We found room for improvement in all these areas. In particular, better information and increased use of electronic tools are needed to modernize control over cards.

7.3 Although available measurements do not point to serious losses at the present time, the severity and number of problems could increase if organizations do not strengthen control and share best practices. Now is the time for the government to assess the card program for emerging risks and the management control processes that should be applied.

Department of Finance — Equalization Program

Assistant Auditor General: Ron Thompson

Responsible Auditor: Jeff Greenberg

Chapter 8 - Main Points

An essential element of citizenship [in the Canadian federation] must be relatively equal access to basic government services, irrespective of place of residence.

Royal Commission on the Economic Union and Development Prospects for Canada, 1985

8.1 This fundamental principle is still the driving force behind the federal government's 40-year-old equalization program, which in 1996-97 transferred \$8.5 billion in unconditional funds to the relatively poorer provinces. Equalization is a responsive program that requires continuing attention and refinement if it is to stay true to its objective.

8.2 Since its purpose is to equalize provincial revenue-raising capacity, the key to its success rests on how well the Representative Tax System, the basis for this program, reflects provincial tax systems. As a result, the program must adapt to the constant evolution of these systems. The legislation requires that the program be renewed at least every five years, providing the federal government, in conjunction with the provinces, with a built-in opportunity to keep the program current. We found that this process works, but that it could be more effective if the federal-provincial committee on equalization began its review of outstanding issues earlier in each new equalization period.

8.3 We believe that there must be a solid basis for knowing how and why the program should change. In this regard, we suggest that there should be guiding principles for the construction of the Representative Tax System and for aspects of the ceiling and floor, two provisions that limit fluctuations in the payments.

8.4 Because final decisions about this program rest with Parliament, we believe that the Department of Finance should make a greater effort to educate Parliament, and the public in general, about how this very complex program works. We also believe that it could use Parliament more effectively, soliciting advice from a wider circle of interested parties, rather than relying almost exclusively on the advice of a committee of federal and provincial officials.

8.5 We found that the administrative process by which entitlements are calculated and payments made is reasonable. However, we noted that outstanding balances owed by provinces to the federal government currently bear no interest, resulting in an additional benefit to the provinces of about \$38 million in 1995-96. We believe that the government should review its policy of interest on outstanding balances owed to, or by, the federal government.

8.6 We were frequently reminded by officials that the equalization program is important to the Canadian federation. However, this program is only as good as the processes that allow it to keep pace with the shifting sands of provincial tax systems. We believe that the current program and its processes for change work reasonably well, but they could be improved. This is both a challenge and an opportunity for the government, and the Parliament it serves.

Foreign Affairs and International Trade Canada — Financial Management and Control

Assistant Auditor General: David Rattray

Responsible Auditor: John Hitchinson

Chapter 9 - Main Points

9.1 Since our 1994 audit, Foreign Affairs and International Trade has continued to improve financial control in areas where problems had previously been identified, specifically the collection of rent from employees and control of money advanced to employees. Financial training has also been improved. While progress has been made in improving basic financial systems, more remains to be done, and an attitude of cost awareness and stewardship needs to continue to be encouraged throughout the Department.

9.2 The \$25 fee added to the cost of each passport issued for recovery of consular costs was based initially on incorrect cost information. Subsequent to our audit, the Department undertook a new calculation of costs. Although this recalculation identified a number of cost increases and decreases, no adjustment to the consular fee appears necessary.

9.3 The Bureau of Physical Resources has introduced a more businesslike approach to managing property in the Department. However, in some areas control over spending on property maintenance remains weak. Large amounts have been spent on renovating and repairing official residences when heads of mission changed, without the missions and the Bureau together clearly establishing the requirements. The Bureau has not developed an overall financial plan for senior management review that presents likely annual expenditures and revenues, and alternative funding strategies for dealing with the uncertainties inherent in capital projects abroad. Information systems do not yet adequately support the property management function.

9.4 The Department has achieved global desk-to-desk communications with the implementation of its Secure Integrated Global Network (SIGNET); however, it has proved to be a greater task than originally envisioned. A new Chief Information Officer (CIO) has been established to be accountable for consolidating the plans and budgets for all information technology expenditures in the Department and recommending priorities. The financial information system was not used in a consistent way for budgeting IT expenditures across the Department.

9.5 The Foreign Service Directives (FSDs) have not changed since our last audit. However, recent initiatives to review these directives from the perspectives of tax, complexity and appropriateness could simplify the FSDs. The Department's ability to analyze and provide information on FSD costs has improved; however, the shared management structure for FSDs is not functioning as effectively as it could. The management of travel under the Foreign Service Directives has improved over the past two years.

Natural Resources Canada — Energy Efficiency

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ellen Shillabeer

Chapter 10 - Main Points

10.1 Natural Resources Canada (NRCan) has been in the business of promoting energy efficiency for many years. The Department has made a fundamental shift in the way it promotes energy efficiency since the mid-1980s when the emphasis was on grant programs. The Department now sees its role as providing leadership and establishing partnerships with others to reduce energy use and to improve energy efficiency. The current focus is on the environmental impacts of energy use.

10.2 NRCan's current set of 16 non-research and development energy efficiency initiatives is a key element supporting Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000. We found that NRCan's current performance information, on both expectations and achievements, is not sufficient to determine the overall success of its energy efficiency initiatives in terms of the contribution they are making to this stabilization goal.

10.3 Departmental expenditures on these 16 initiatives were about \$16.5 million in fiscal year 1995-96. Of the extensive range of policy instruments available to encourage energy efficiency, the Department uses a limited number of instruments, namely selective regulations, information and voluntary action.

10.4 The objectives established for many of the energy efficiency initiatives do not provide a clear and concrete expectation of achievement against which the Department can assess its progress and report to Parliament. More work must also be done to measure and assess the overall achievements of its initiatives, including the development of appropriate links to the stabilization goal. The Department is taking steps to improve the quality of its performance information, where cost-effective and feasible.

10.5 Opportunities exist to enhance departmental transparency and accountability by better reporting to Parliament on both the performance expectations and performance achievements of the individual initiatives.

10.6 The Department has begun to lay the foundation to improve the energy efficiency of its own facilities and fleet of vehicles, and it expects to achieve its current targets by the end of 1997-98.

To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 1997 to the House of Commons, to be laid before the House in accordance with the provisions of section 7(5) of the *Auditor General Act*.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 29 April 1997

**Report of the
Auditor General of Canada to the House of Commons - 1997**

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Chapter 1

Maintaining a Competent and Efficient Public Service

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Maintaining a Competent and Efficient Public Service

Assistant Auditor General: Maria Barrados

Responsible Authors: Alick Andrews and Otto Brodtrick

Main Points

1.1 The public service's effectiveness, and the efficiency with which it carries out its functions, are crucial to the quality of governance and to the economic, social and political health of the country.

1.2 About 500,000 men and women have some form of employment in the federal public sector; about 207,000 of those constituted the traditional public service as of March 1996. The federal public service is an institution under pressure to change and adapt: pressure from Canadians, the economic-political environment, and advocates of management reform. All participants in our study were convinced of the importance of building on the strengths of the past to ensure that Canada enters the twenty-first century with a modern, world-class public service.

1.3 Particular attention needs to be given to renewing and rejuvenating the public service work force; resolving long-standing human resource management issues; establishing a more constructive dialogue on performance and partnership; and continuity of leadership and persistence in moving forward.

1.4 The public service faces the challenge of identifying and filling the gaps resulting from recent departures, as well as building the human resource capacity to meet new challenges and provide for a strong public service in the future. Problems with three of the important personnel systems need to be addressed. Various attempts have been made to modernize them but more needs to be done.

1.5 Improved ways of dealing with shortfalls in administrative performance need to be found. An effective public service needs a Parliament and media that can fairly discuss errors in the context of overall performance.

1.6 Persistent and ongoing effort is required to address these challenges. Further discussion and debate are required on the future size and tasks of the public service and on the organizational approach to take.

Introduction

1.7 Canadian society and its institutions are under pressure to change. This study examines one of those institutions — the federal public service — and the challenges it faces.

1.8 Considerable attention has been given in Canada to addressing these challenges through reforming the federal public service. Public Service 2000 (PS2000), announced in 1989, proposed a new management approach, one that stressed results supported by appropriate process, judgment within reasonable rules, and innovation while managing risk. As originally planned, it appeared to have the potential to address specific human resource and other management issues that needed attention.

1.9 PS2000 has been absorbed into a broader renewal exercise. A new government introduced a fundamental review of government programs and significantly reduced expenditures. More recently, deputy minister task forces examined a range of issues, including service delivery models, the future of the public service, management of overhead services, values and ethics, management of horizontal policy issues, and strengthening of the policy-making capacity.

Focus of this study

1.10 From time to time, the Office of the Auditor General has examined public service management and reform issues, including performance, values, organizational learning and innovation. One of these studies, in 1983, dealt with constraints to productive management. It identified the impact of political priorities on the management process, the degree to which managers have to cope with administrative procedures, and the disincentives to productive management that are characteristic of the public service. It also noted that certain constraints are part of the nature of government and may be difficult to change.

1.11 **Objective.** This present study (see **About the Study**) was undertaken to draw to Parliament's attention some of the areas that we believe are particularly important to the continued well-being of the Canadian federal public service. This Office shares Parliament's interest in maintaining a competent and efficient federal public service that will serve Canadians well, now and in the future.

The Case for a Vigorous Public Service

What is the federal public service?

1.12 According to a Statistics Canada report, published in 1996, about 500,000 men and women have some form of employment in the federal government and government corporations (see Exhibit 1.1). This includes everyone who is employed to carry out the responsibilities of the federal government: public servants in departments, employees of Crown corporations, and members of the military and the RCMP. In the eyes of many Canadians, this is "the federal public service", although a technically more correct label for it is "the federal public sector".

Exhibit 1.1

(This exhibit is not available, see the Report.)

1.13 Our focus in this study is on the traditional federal public service, which comprised about 207,000 people in March 1996 (see Exhibit 1.2) and is a subset of the federal public sector. Public servants are employed under specific pieces of legislation that define the public service of Canada. Although our analysis deals with the public service, much of what we say may well apply to a significant portion of the broader federal public sector. Public sector organizations, although technically outside the public service, can still have strong public service traditions as they carry out their work in the public interest.

Exhibit 1.2

(This exhibit is not available, see the Report.)

What is the purpose of the public service?

1.14 The public service is part of a larger system of governance and, as such, it affects and is affected by the other elements of this system. The government makes public policy and the public service manages its implementation. In a democracy such as ours, the making of public policy is the stuff of politics — mobilizing, focussing, articulating, and compromising among the interests of individual Canadians through the mechanisms of the media, political parties, special interest groups and the electoral process, all within a framework of political institutions and traditions.

1.15 The purpose of the public service is to support ministers by carrying out policy analysis and bringing forward policy proposals designed to achieve government objectives, and by translating policy decisions into action. These actions may be carried out by the public service itself, other parts of the public sector, or others.

1.16 The public service acts in the interests of Canadians as identified and defined by those who are elected to govern. The public service reflects Canadians' joint purposes, past and present, and owes its existence and development to the common values they hold. Today's public service, with its structure and variety of activities and services, mirrors Canada's history and the needs Canadians have chosen to address through the political arena. Its effectiveness, and the efficiency with which it carries out its functions, are crucial to the quality of governance and to the economic, social and political health of the country.

1.17 A ministerial council of the Organization for Economic Co-operation and Development (OECD) has concluded that global economic integration will make an effective public service increasingly important to the performance of the private sector. In other words, an efficient and competent public service is one of the institutional structures that contributes to effective economic activity. As such, it helps Canada compete with countries that have a similarly well-developed public service, and provides Canada with a competitive advantage over those countries that do not.

What does the public service do?

1.18 One principal role of the public service is to provide policy advice to ministers. This role is carried out primarily by the more senior members of the public service, with staff support. It involves such matters as definition of issues, consultations with interested parties, identification of options, analysis, consensus building, consultation with other sources of policy expertise, and development of recommendations.

1.19 Another role of the public service is to deliver a wide range of services, and apply the regulations that result from public policy decisions. On any given day, public employees deliver many services, from customs services to ice breaking, and from agricultural research to food inspection. These represent some of the goods and services that Canadians, as represented in Parliament, have decided to provide for themselves through delivery by the public service.

1.20 The third role of the public service is to deal with issues that never make their way onto the public and political stage. These administrative practices are developed in the context of the administrative framework legislated by Parliament.

1.21 To summarize, what the public service must do, and do well, is to propose policies, manage programs and services, and develop and implement administrative practices.

A competent public service

1.22 To be competent and effective, a public service needs individuals with the requisite commitment, skills, knowledge and experience. As an organization, it also needs the ability to learn, and to adjust and renew itself in the face of continuing rapid change.

An efficient public service

1.23 An efficient public service is one that carries out its functions in the best possible and least wasteful manner. This means always working to improve the way things are done. In the absence of market force incentives, the public service has an even greater obligation to make good use of resources and available instruments in doing its work. It must innovate, learn and improve.

Public service values

1.24 Common values, strongly held, are a critical aspect of a competent and efficient public service because public administration relies on judgment. Many government activities defy detailed description of all possible choices and results. There is usually not one single clear option, and in many cases multiple options exist with a range of possible results. Separate constituencies may have different, often conflicting expectations about what government programs should achieve, and politics is about reaching consensus through creativity and compromise.

1.25 Public administration is about managing toward goals that may be individually imperfect but on the whole are politically acceptable. Frequently, managers are confronted with imperfect and incomplete performance information and a glut of subjective opinions. Public service values provide the normative controls that guide decision making. In our view, the role of values is so critical that the quality of public administration varies in relation to the strength with which they are held. Therefore, the care and nurturing of the system supporting public service values is an issue of the first importance.

1.26 The public service is expected to act in the public interest, and to be politically neutral, anonymous, impartial, dedicated, professional, and loyal to the government of the day. It is expected to provide efficient, effective and fair service to individuals, groups and society. There are inevitable tensions between some of these values. For example, there is a tension between fairness to society and responsiveness to individuals, and similarly, between due process and efficiency. Yet the essence of a public service is defined by these expectations. It must manage these tensions and still follow high standards of professionalism and of service to elected officials and to citizens, even under conditions of rapid change.

1.27 These values are entrenched in the public service organizations, their mandates, their systems and practices, and in the people who hold positions in the public service. The values of the public service give it continuity over time and stability. The public service, through its institutional continuity, has an enduring connection with the society it serves.

1.28 The public service is expected to take a long-term view when advising on policy, since serving the public interest demands looking well into the future. In comparison, the life of a Parliament is relatively short. This

presents a potential for tension, but it is a healthy tension because ministers should expect their policy advisors to consider all implications when recommending policy. Through its enduring connection with society, the public service reflects society's values and interests. In return, it should enjoy legitimacy, trust and support.

Study Findings

The Pressure for Change

Pressure from Canadians

1.29 While discussion and debate about the size of government and the range and extent of public services goes on, most Canadians still expect their government to actively provide critical programs and services. Interestingly, Canadians continue to place considerable trust in public servants at the same time as they are increasingly distrustful of "government" overall. Opinion surveys (see example in Exhibit 1.3) point to the public's interest in improving governance by ensuring accountability for results, increasing federal government consultation with stakeholders, and increasing transparency in federal government decisions. These expectations imply that change is needed on the part of elected officials as well as public servants.

Exhibit 1.3

(This exhibit is not available, see the Report.)

"Societies get the public services they expect. If people believe that government is bumbling, and bureaucratic, then that is what it will be. If, in contrast, they recognize public service for the noble calling it is, then they will end up with strong government."

(Note: Throughout the chapter, verbatim quotations from our interviews illustrate the material in the text.)

1.30 In addition to expecting consultation and transparency from their government, Canadians feel that the delivery of public services should be improved. One public opinion survey shows that Canadians consider services to fall short in promptness, reliability, convenience, openness and candor (see Exhibit 1.4).

Exhibit 1.4

(This exhibit is not available, see the Report.)

Pressure from the economic-political environment

1.31 The public service is subject to powerful international forces, including the globalization of capital, markets, knowledge, labour and social issues. Furthermore, there are rapid changes due to technology and international competition. These will increasingly require sound policy advice from well-trained and experienced people.

"There isn't a department in the government that isn't impacted by what is going on in other countries."

1.32 The public service is also affected by the aging of the Canadian population, as well as the continuing discussion on the Constitution and the respective roles of the federal and provincial governments, which adds to a

sense of pressure. Another major source of pressure has been the government's determination to deal with the large annual fiscal imbalances through cuts to government spending.

1.33 As far as anyone can tell, there will be no letup in the rate of change and in the intensity of pressure. If anything, the rate of change will likely increase. For a large and complex organization such as the Canadian public service, building—in the capacity to adjust and keep pace represents an enormous challenge.

Pressure from advocates of “new public management”

1.34 Analysts of the public service in Western countries advocate efficiency-driven change in the public service, resulting in:

- a bold use of marketlike mechanisms for those parts of the public sector that cannot be transferred directly into private ownership;
- intensified organizational and spatial decentralization of the management and delivery of services;
- a constant rhetorical emphasis on the need to improve service quality; and
- an equally relentless emphasis on customer satisfaction.

1.35 A study by the OECD suggests that future public services will adopt this approach, resulting in a public sector that will:

- be less involved in direct service provision;
- concentrate more on providing a flexible framework within which economic activity can take place;
- regulate better, with more complete information about likely impacts;
- continuously evaluate policy effectiveness;
- develop planning and leadership functions to respond to future economic and social challenges; and
- take a more participative approach to governance.

1.36 These emerging global views — which are already practised in some jurisdictions — challenge traditional views of a single public service dominating the public sector. They suggest a vision of a public service in which a small corporate core, a number of quasi-autonomous public service departments, an arm's-length public sector, and the private sector work together to deliver the services that have traditionally been provided by a centralized public service.

1.37 The new approaches raise a number of questions that need attention and discussion. Some of them are: What kind of public service does Canada want? What part of society's work should be done in or by the public sector? What set of values should govern the provision of public goods and services? Should the public service focus exclusively on efficiency, or also satisfy other societal goals such as, for example, being representative of the population as a whole in its composition? What should be the criteria for the migration of public service functions to the private sector?

1.38 These questions about approaches to public service and public management deserve debate with all stakeholders in order to agree on the nature of the Canadian public service as it evolves toward the future.

The Public Service Today

1.39 The public service today reflects not only the results of long-standing traditions and practices, but also of recent initiatives to reduce budgets and introduce reforms.

A portrait

1.40 Exhibit 1.2 shows that the number of public servants has declined steadily from over 240,000 in 1992 to about 207,000 in March 1996. The present size and composition of the public service is the result of successive downsizing initiatives after a long period with little turnover. In particular, recent budget reductions resulted in early retirement and departures of thousands of public servants. In 1995-96, for example, there were almost 20,000 separations (indeterminate employees) from the public service, compared with fewer than 10,000 in each of the three preceding years (see Exhibit 1.5).

Exhibit 1.5

(This exhibit is not available, see the Report.)

1.41 The Public Service Commission, in its 1995-96 annual report to Parliament, provides the statistical portrait of the people who make up today's public service. The largest proportion of them work in four large departments: Revenue Canada, National Defence, Human Resources Development Canada, and Public Works and Government Services Canada. The Commission also reports that the public service is increasingly made up of professionals, with improved representation of women and improved bilingual capacity.

1.42 The same report points to a decline in indeterminate hiring and an increase in term appointments. For example, just four percent of appointments to the public service between April 1995 and March 1996 were for indeterminate employment. The others were for temporary work, including student employment.

1.43 The Public Service Commission reports that the age structure of the public service is changing markedly. Exhibit 1.6 shows a comparison of the sizes of different age groups in 1986 and 1996. The most recent age profile shows a concentration in the middle age group, with fewer younger workers and fewer older workers. It is particularly noteworthy that, in 1996, less than 9 percent of public servants were under 30 years of age, compared with almost 17 percent in 1986. This, combined with the recent downsizing and the resulting loss of the experience of those who retired, raises the concern that the public service is not adequately renewing its skills and that it has experienced a loss in its knowledge base. Further, it raises the question of the contribution the public service is making to developing the future leaders of Canadian society.

Exhibit 1.6

(This exhibit is not available, see the Report.)

1.44 Many public servants feel under growing pressure to take on more work and to meet new and increasing demands, all the while with fewer resources. Their salaries were frozen for over five years, and recent increments are viewed as modest at best. One senior official suggested that the new expectations amount to a demand to produce "cheap excellence" — service that is world-class but that should cost next to nothing. These factors, in addition to continued downsizing and the introduction of new program delivery structures, have left a work force that feels less secure, less valued, and weakened in its capacity to meet changing demands.

A changing role and fewer resources

1.45 Program Review was announced in the February 1994 Budget as a strategic review of government operations to “get government right”. It was also meant to help restore fiscal responsibility and bring the federal deficit under control. The review would “provide a rational basis for a significant transformation of the federal government. The goal is a federal public sector that works smarter, spends smarter and gives Canadians more of what they genuinely need.” Financial targets were set over a three-year period and individual entities were given the responsibility to meet these targets according to their own priorities. The process was directed by ministers and carried out by the central agencies and senior public servants.

“We need to get our program structure focussed on the things the federal government absolutely has to do, and invest in the people, the programs, and the institutions we need to deliver them. Do it in the most innovative way and in ten years we could easily be renowned as the best government in the world. ”

1.46 A series of six guidelines was developed to assist departments and agencies in reviewing their activities (see Exhibit 1.7).

Exhibit 1.7

Six Guidelines of Program Review

The Program Review asks departments to review and assess their activities and programs against the following guidelines:

1. Public Interest Test - Does the program area or activity continue to serve a public interest?
2. Role of Government Test - Is there a legitimate and necessary role for the government in this program area or activity?
3. Federalism Test - Is the current role of the federal government appropriate, or is the program a candidate for realignment with the provinces?
4. Partnership Test - What activities or programs should or could be transferred in whole or in part to the private/voluntary sector?
5. Efficiency Test - If the program or activity continues, how could its efficiency be improved?
6. Affordability Test - Is the resultant package of programs and activities affordable within the fiscal constraints? If not, what programs or activities would be abandoned?

1.47 These six questions, and the order in which they were asked, demonstrate the two main thrusts of the initiative: first, to redefine the program responsibilities of the federal government; and second, to reduce their cost. Program Review has had a significant impact. It reduced government expenditures as well as the size of the public service. It also reinforced the message that there were limits on the government’s ability to undertake new programs and initiatives.

1.48 The success at redesigning programs was uneven. Some departments, such as Transport Canada, have been cited as models of reducing expenditures and redesigning programs (see Exhibit 1.8). Others are beginning the process of rethinking the functions of their departments.

Exhibit 1.8

Program Review at Transport Canada

The goal was to redefine the role of the Department, to reduce its size and, in the process, still provide effective services at affordable cost. Officials of the Department, supported by staff, analyzed and explored existing policies. They then presented policy alternatives. The Minister took selected proposals through the political process. The Deputy Minister then moved to implement the changes in the Department.

The case illustrates the importance of collaboration among the Minister, Deputy Minister, and departmental staff. The courage to act and the willingness to participate in a common effort is a powerful formula for achieving results. This initiative is by no means complete, but it is well under way.

1.49 One of the consequences of Program Review is that managers are being encouraged to focus more on results than inputs. The underlying strategy of shifting the focus to results was to also change supporting systems and processes.

Burdened by cumbersome personnel systems

1.50 The White Paper *Public Service 2000: The Renewal of the Public Service of Canada*, issued by the government in 1990, emphasized the goals of improving service to Canadians and of having a more people-oriented public service. Seven years after PS2000 was announced, there is a general consensus that the objective of simplifying the government personnel regime has not yet been realized, in spite of reforms introduced by the *Public Service Reform Act* of 1993.

1.51 For example, the Treasury Board's personnel manual, now partly on CD-ROM, and the Personnel-Pay Input Manual total more than 12,000 pages of rules, instructions, guidelines and directives, including some 70 collective agreements and classification and job evaluation standards. There are still some 840 rates of pay and more than 70,000 rules governing pay alone. In addition, the Public Service Commission and departments have developed rules that affect personnel management.

1.52 The rules lead to a large volume of personnel transactions that require significant administrative effort and talent to process. Not surprisingly, public service managers are frustrated with the administrative burden and apparent inflexibility of the personnel system. Yet they realize that any effort at simplification needs to take into account the need for "due process", the values of a professional public service, and an appointment system that is protected from partisan politics.

A climate of uncertainty

1.53 Recent changes within the federal government have served to create a sense of collective uncertainty about what it means to be a federal public servant, and individual uncertainty about the wisdom of choosing a public service career. A profound change in attitude is apparent.

1.54 The reform initiatives of the last few years are viewed by many as having fundamentally changed the nature of the "public service contract." Many public servants believe that the implicit employee contract, which trades off security of tenure during satisfactory performance for neutrality and non-partisan loyalty to the government, has been broken. For support of this view, they point to the government's decisions to change legislation to modify security of tenure in order to permit downsizing.

1.55 Others have argued that there never was such an implicit contract. Instead, a long period of unprecedented public service growth from the 1940s to the 1980s helped reinforce the idea of security of tenure. Later events, such as the Government Work Force Adjustment Directive of 1991, had the same effect. In any case, the downsizing of government has demonstrated that the assumptions held by many about the security of employment do not reflect the current situation. For many public servants, this redefinition of the employment relationship has contributed to a sense of uncertainty about their future.

"True, a lot of people are leaving because of the uncertainty, but they also have in the back of their mind that their work is not valued."

"There is a definite sense that people just don't feel that anyone cares anymore."

1.56 Working in the public service, many told us, used to be more than just a job: it was an opportunity to make a difference. Now, they say, working in the public service is a job like any other and a discouraging one at that. The number of front-line and middle managers who would not choose to become public servants again, given that choice, has gone up over the last six years (see Exhibit 1.9). In the eyes of its members, the public service falls short in opportunities for personal growth and development, job security, ability to serve the public interest, and income (see Exhibit 1.10). Our study indicates that many of those who have remained in the reduced public service feel that their future is uncertain and their performance and commitment to service unappreciated.

Exhibit 1.9

(This exhibit is not available, see the Report.)

“You have quite a considerable population between the ages of 45 and 50 who are at best hanging on to their job, and looking for the right timing rather than get unceremoniously dumped. That has to spell disaster for running a program.”

Exhibit 1.10

(This exhibit is not available, see the Report.)

1.57 This current climate of uncertainty in the public service is worrisome on two counts. First, as the morale of public servants suffers, so too will their commitment. Second, public service values — which many public servants associate, rightly or wrongly, with the idea of a “professional” or continuing public service — are at risk when many of them feel that the government has not kept its part of the “contract”.

A beleaguered executive

1.58 The most-senior managers feel least uncomfortable about their career choice (see Exhibit 1.9), even though many of them, including several deputy ministers, have recently left the public service. This is borne out by comments from the senior executives at the next level. They feel that while they continue to deal with the stress of downsizing in their departments, their deputy heads have moved on to new policy development as if the downsizing challenge were behind them.

1.59 All executive-level managers are concerned, however, about the declining morale of employees. In a recent survey of the executive group, its members expressed strong concern about decreasing commitment, lack of recognition and eroding morale. The deputy minister task force on service delivery models identified three explanatory factors for this decline in morale: employees feeling undervalued, the climate of uncertainty, and having to meet high expectations with diminished resources.

1.60 As a group, executives view themselves as under stress because of the slow evolution of human resource policies, strategies and programs. They are also anxious because of, on the one hand, loss of staff due to downsizing and, on the other, the siphoning off of marketable specialists and professionals into the private sector (see Exhibit 1.5), where pay and benefits are typically higher. Adding to these anxieties is the need to cope with rapid change, overwork, high performance expectations, and a sense of uncertainty about their own future in the public service. Yet this is the very group who, with their deputy ministers, must be an example and provide leadership for the work force.

“What bothers senior public servants is not only the freeze on pay, but the freeze on opportunities, on doing new, interesting and innovative things. That’s the message I’m hearing all the time. And when people feel unappreciated, bored, and frustrated with their job, they then become aware that they are also under a salary freeze. It reinforces discouragement.”

1.61 In summary, the public service today is an institution under stress. It is smaller than it has been, increasingly middle-aged, difficult to enter, unclear about its role, and has fewer opportunities for promotions (see Exhibit 1.11) and fewer resources to carry out its responsibilities. It is subject to ongoing program reform and new forms of program delivery. And it is encumbered by rule-bound personnel systems. The public service today operates in a climate of uncertainty, its executive group feeling beleaguered and concerned about its own declining commitment, motivation and morale.

Exhibit 1.11

(This exhibit is not available, see the Report.)

What Needs Particular Attention?

1.62 Many public servants feel that traditional public service values and approaches are under siege. Others argue that this is an opportunity to set a new course, that out of the stress of rapid downsizing and the pressure to reform will come a streamlined, renewed and strengthened public service. Whether this more optimistic prediction turns out to be accurate will depend on the resolution of a number of outstanding issues and on strength of resolve in building a new public service.

1.63 People are the principal resource of the public service, and managing them well is the key to its ability to cope with new and evolving demands. More than any other factor, good management of the public service involves maintaining this human resource with its competencies and its core values of serving Canadians. No proponent of change wants to erode these values and undermine the commitment of the public service to act in the public interest.

1.64 Based on the results of our study, the following areas deserve particular attention in order to maintain a competent and efficient public service:

- renewal and rejuvenation of the public service work force;
- resolving long-standing human resource management issues;
- establishing a more constructive dialogue on performance and partnership; and
- continuity of leadership and persistence in moving forward.

Renewal and rejuvenation of the work force

1.65 The leadership of the public service recognizes that it needs to focus on its people. The Public Service Commission, in its 1995-96 Report to Parliament, identified the shifts in demographics that have occurred. It pointed to limited recruitment, which has helped produce a public service that is increasingly middle-aged. Programs designed to attract highly talented and motivated graduates to join the public service are not working well, according to the most recent report of the Clerk of the Privy Council to the Prime Minister. In addition, the large numbers of recent departures from the public service have left gaps in expertise and knowledge in many areas. In our view, a particular concern should be identifying and filling these specific gaps as well as building the overall human resource capacity to meet new challenges and provide for a strong public service in the future.

1.66 **Strengthening the policy capacity.** Strengthening the public service's ability to provide sound policy advice is an area that needs a longer-term solution. Developing policy and providing policy advice to ministers is considered a key role of the public service. This advice is provided by the most senior public servants, supported by

the analytical work of their departments. The Clerk of the Privy Council, in a report that preceded the most recent downsizing exercises, expressed her concern about the diminished policy capacity in government. Since then, downsizing has further weakened this function, because early retirement incentives encouraged some of the most experienced individuals to leave. This is a concern because it affects the ability of the public service not only to provide high-quality policy advice but also to maintain the pool of men and women from whom the leaders of the public service have traditionally been drawn.

1.67 One of the deputy minister task forces was specifically asked to examine the policy capacity in government, in recognition of the fact that “all might not be right with the policy capacity of the federal government.” The task force confirmed the importance of a strong policy capability in government and acknowledged some of the concerns. It was concerned that insufficient time and effort are devoted to reflection and longer-term interdepartmental discussion among senior officials. The problem, as one commentator put it, is one of “the urgent driving out the important.” Central to the recommendations made by the task force is the need for renewal and improved recruitment into the public service, and for partnerships with the external research community, as ways of rebuilding the public service’s policy capacity.

1.68 The public service is now relying increasingly on consultants, sometimes former public servants, and external organizations to do this analysis. There is potential to gain good value by drawing on former public servants. External consultation is and always will be a necessary part of policy formulation. However, while government is currently meeting its policy analysis requirements in the short term, the “contracting-out” approach does not provide for developing the next generation of policy advisers and senior public service leaders.

1.69 **Strengthening competence and commitment.** The knowledge and commitment of its people are the public service’s most important assets, which must be rebuilt and updated to keep pace with changing conditions. This poses a challenge to management, and to the various training and development programs of the public service.

1.70 A number of services to the public have moved from the traditional public service to other parts of the public sector, the private sector or the not-for-profit sector. Such a newly defined structure would, early on, have to define the skill set that is required to ensure its smooth operation, such as managing contractual obligations and ensuring that accountability is working and proper service is delivered.

Resolving long-standing human resource management issues

1.71 While PS2000 specifically sought to improve human resource management in the public service and to reduce the heavy burden of rules and procedures, considerable effort has resulted so far in little change. Program Review reduced the size of the public service but did not address a number of the outstanding people-management issues. This was left to other change initiatives.

1.72 Problems with three of the most important personnel systems need to be addressed. Various attempts have been made to modernize them, but more needs to be done to improve the systems of classification and job evaluation, staffing, and collective bargaining.

1.73 **The classification and job evaluation system.** This initiative was planned as a conversion to a modern classification and job evaluation system, and was an important part of public service renewal. In 1990 we noted the relatively high number of occupational groups in certain departments and agencies. We reported that six departments had at least 40 occupational groups, and that one of them had 56. We concluded that a fundamental change was necessary.

1.74 At the time, we recognized that this represented a significant challenge, particularly while respecting the requirement for pay equity. As we reported in May 1996, this challenge, including simplification of the

occupational group structure, has been only partially met, although discussions are continuing among Treasury Board, unions and departmental officials, and efforts are under way to complete the initiative.

1.75 The staffing system. As a result of the *Public Service Reform Act*, there has been a move toward simplifying the system of attracting and recruiting people, and matching them to suitable work. However, studies and reviews by the Public Service Commission show that neither managers nor employees are satisfied with the existing system. Managers feel that the system should be more efficient and more timely. Employees feel the current system is not consistently fair and does not consistently protect merit.

1.76 The collective bargaining system. Over the last 20 years, collective bargaining rights have been modified or suspended for a total of almost 10 years. Legislation has modified or suspended agreements and salary and working conditions. Collective bargaining is expected to resume in 1997. The process and scope of bargaining has also changed over the years. A process has developed in which job security under the Work Force Adjustment Directive is “negotiated” independent of salary and other work conditions. Management and unions have not consistently collaborated in resolving human resource management problems. On the positive side, unions are now actively participating in the development of the *Universal Classification Standard* and the government initiative to develop a human resource framework better suited to the management of scientific personnel.

1.77 These issues need resolution. Action on these three issues holds the promise of freeing up the process of managing people in the public service. Yet there are underlying factors that can influence the resolution of these issues. The “new public management”, for example, focusses strongly on the importance of efficiency and responsiveness. It would argue that the pay of people should be based on local market conditions, rather than on public-service-wide pay rates.

1.78 Moving service delivery operations out of the public service currently offers the potential for more streamlined operations, because of troublesome systems and processes in the management of people in the public service. However, such devolution needs to be done on its own merits, not simply to avoid bureaucratic constraints in the public service. While conscientious efforts have been made to improve human resource management in the public service, its leaders and their political masters need to address these constraints.

Establishing a more constructive dialogue on performance

1.79 Public servants are accountable to ministers for administration. Ministers answer in the House of Commons for the discharge of all their responsibilities, including those they have delegated to others. The function of the opposition is to challenge the performance of the government, and hence the minister. This challenge is an essential part of our system of government.

1.80 Government is getting more complex, and many administrative matters are far removed from the minister’s direct purview. The traditional ideals — that the minister is all-knowing, and that public servants must do nothing to potentially embarrass the minister — become more and more difficult to achieve.

1.81 Public servants are being asked to do more with less and to assume more risk; ministers are subject to scrutiny by the opposition and seek to reduce risk. These pressures work against full disclosure of shortcomings as well as successes, and thereby limit constructive discussion on how change can be made.

1.82 Canadians expect the public service to be more open and transparent in its aims and operations. They expect explanations of what it does, why, and at what cost. Transparency and openness do not mean “reporting everything”. Sheer volume would make that impractical for everyone concerned. Rather, meaningful accountability includes reporting what is relevant and in the public interest, with other information made accessible on request to anyone who needs it. Only when citizens and public servants better understand each other’s situations will it be possible to move toward an informed dialogue and to make changes that meet common expectations.

“The idea is to encourage more and more people to fulfill their responsibilities as citizens and for government to be especially sensitive to the voices of these citizens — not merely through elections but through all aspects of the design and implementation of public policy.”

1.83 There are a number of areas in which public servants and public service managers can make changes without having to address some of the inherent tensions in the system. Shortcomings in service delivery elements such as courtesy, empathy or understanding, and reliability do not require more rules and controls, but require changes in attitude and approach. The size of the gap reported by the survey shown in Exhibit 1.4 suggests considerable room for improvement.

“The job of management is to support the employee at the front desk. The key support is to provide all of the information that the person will need to make valid assumptions, take risks, and make decisions. The front-line employee must have all the information she needs to take risks in a successful way.”

1.84 As our audit on service quality discussed (September 1996, Chapter 14), public service managers were working to implement service standards in the principal services of government. But they were falling short in posting their service standards and actual performance against them. As we noted in that chapter, this was due to their reluctance to make publicly visible a negative result, which service managers felt would lead to embarrassment and lack of support. This illustrates the potential dilemma for public servants as they are asked to engage in a more constructive dialogue on performance.

1.85 The challenge facing the public service is the way citizens and parliamentarians deal with shortfalls in administrative performance, which can and do occur. There are some lessons to be drawn from the government’s Service Standards Initiative, which suggests developing a consensus on realistic standards to be attained. This means discussion, research and dialogue so that all the interested parties share in the decision on what is achievable. With this approach, public servants are not on their own in setting the goals. While the initiative focussed on those being served, there is no reason why public servants and ministers could not include members of Parliament in this dialogue.

“We should recognize just how much contact there is between the public servant and the citizen. We should be proud of what we’ve got. And we should expect that every once in a while a public servant may be having a bad day but that doesn’t mean that we should do a full-blown inquiry, or sort of whip ourselves into a frenzy.”

1.86 A key problem is how to deal with honest errors — those efforts that, despite the best of intentions, fall short of expectations. Where performance falls short of expectations, this should be seen as an opportunity to learn. Managers ought to be using the information gained to understand what the shortcomings were, and adjust their operations, taking this new knowledge into account. In some cases, expectations may have been unrealistic from the start, and better planning may be indicated.

1.87 An effective public service needs a Parliament and media that can fairly discuss errors in the context of overall performance. Where rules and control frameworks are too rigid or out-of-date, Parliament needs to be informed so that changes can be made. Instead of continuing the long tradition of exacting accountability for individual errors, a shift of focus to the nature of corrective action would shift the emphasis to improvement. Members of Parliament, the public and the media ought to demand in their scrutiny that this kind of correction occur. Indeed, it is perhaps the absence of learning rather than the absence of perfection that most warrants criticism.

Continuity of leadership and persistence in moving forward

1.88 It is widely acknowledged that the public service is under stress and that changes are needed. What has proved difficult for the public service is to act vigorously on recommendations, with the notable exception of the Program Review initiative, which was driven by political will. Some senior people we consulted about

implementation pointed out that there are many good ideas in the public service, but not the corresponding consistent bold implementation.

“We see rapid change and great complexity around us, but caution and limited flexibility in the way we work. This often results in slow, limited or no implementation.”

1.89 Part of the reason for this difficulty is that one of the purposes of the public service is to ensure consistency, stability and “due process” in public administration. Another part is that the public service cannot implement boldly without political support.

“One of the principal constraints is political pressures. “Leadership” is good until the day it embarrasses the government, and officials have to work within the limits of what their ministers will accept.”

1.90 A further reason for slow implementation is that champions of change are moved regularly and the process of defining policy and direction starts again. Frequent movement of leaders by rotating them through many senior positions, even though this may be for developmental purposes, makes it difficult for them to focus on long-term change initiatives. If there is also a departure of many senior, experienced people, including deputy ministers, the problem is exacerbated. Continuity of leadership, and persistence, are required to bring about the implementation of needed changes.

1.91 Directions for change have been mapped out over time, including studies done by the recent deputy minister task forces. The time is right to act on what has been learned.

Conclusion

1.92 The participants in our study all were convinced of the importance of building on the strengths of the past to ensure that Canada enters the twenty-first century with a modern, world-class public service. The nature of that public service is being redefined. The provision of some services is being shifted out of the traditional public service. In addition, reform efforts are continuing to improve the efficiency and effectiveness of the public service.

1.93 At this time, the future size and tasks of the public service and of related public sector entities, and the organizational approaches to be used, are still open questions. On a case-by-case basis, the government is making decisions on which functions should remain in the core public service and which should migrate elsewhere, and what the nature of their relationship with ministers should be. This warrants further debate and discussion.

1.94 The public service, regardless of its size and composition, must remain contemporary in its approach to management systems and procedures. Its recruitment and compensation, the use of technology, and the push to administrative efficiency need to be in line with those of other large organizations in Canada.

1.95 Four areas require particular attention:

- Renewing and rejuvenating the work force in the public service — ensuring a vibrant public service for the twenty-first century.
- Resolving long-standing human resource management issues — removing barriers to the management of people.
- Establishing a more constructive dialogue on performance — dealing fairly and effectively with individual shortfalls in the context of overall performance.

- Continuity of leadership, and persistence in moving forward — demonstrating perseverance in direction, and congruence between words and deeds.

1.96 Action is required because in the face of rapid change the public service cannot afford to stagnate. It may not get everything right the first time. It needs to explore, experiment and implement. And it needs to learn from its actions so that it can become more competent at changing, adapting and progressing, and at maintaining a productive fit with its changing environment.

1.97 In resolving some of the more fundamental issues, the public service will need to engage in discussion with its partners: government, Parliament and citizens.

1.98 We have noted throughout this chapter that new realities are challenging government and its institutions. Fiscal pressures, globalization, new technology, complexity and accelerating change are all sources of pressure for change. In addition, budgets have been reduced and programs and staff significantly downsized. At the same time, public confidence in government has declined. Canadians criticize it as costly and unresponsive. They demand a competent and efficient public service that will serve them well, now and in the future.

1.99 Government has responded to these challenges with various studies, strategies and a range of initiatives. Through Program Review, it looked at the size, scope, composition and cost of departments and agencies. Through deputy minister task forces it explored the alternative service delivery structures and other areas. Through La Relève, a recently announced initiative, it is attempting to attract, retain and motivate a talented and dedicated work force.

1.100 As our study points out, persistent and ongoing effort is required to rejuvenate the work force, address a number of long-standing human resource management issues, develop a more constructive dialogue on performance, and maintain the public service as a vibrant institution.

Treasury Board Secretariat's comments:

- *The chapter provides a very good representation of the responsibilities of the public service, the environment in which it operates and the pressures it faces, and the high degree of professionalism that individual public servants bring to their responsibilities. We could not agree more that a “vigorous public service” makes a significant contribution, indeed is essential, to the well-being of Canadian society. It is also interesting to note that most of the issues identified by the Auditor General are not unique to the Government and Public Service of Canada, but are in fact variations of the same concerns facing most Western governments.*
- *The last few years have been difficult ones for public servants as they have been professionally and personally affected by changes in the priorities, programs and structures of the federal government. Yet, our very success in meeting our fiscal and Program Review objectives is due in large part to the skill, dedication and contribution of public service employees.*
- *With respect to the specific recommendations contained in this chapter, work is under way to address many of the issues identified. For example;*
 - *Renewing and rejuvenating the work force in the public service. We are developing and implementing the La Relève initiative, which is a series of service-wide and organization-specific activities to ensure continuing leadership in the public service, to strengthen our policy capacity, to improve career mobility and development opportunities for employees and to provide a work environment that is both supportive of individuals and enables them to make their best contributions.*

- *Resolving long-standing human resource management issues to remove barriers to the management of people. We are simplifying and modernizing our classification and job evaluation system, which will be a critical underpinning of other reforms to the human resource management framework; we have returned to collective bargaining after a six-year hiatus and we are working with the public service unions to simplify and improve the collective bargaining process itself. We recognize the need to examine other fundamental reforms and will do so.*
- *Establishing a more constructive dialogue on performance. Through the Improved Reporting to Parliament project, we are making the information we provide to Parliament on government plans, priorities and results achieved more accessible and more understandable. Sixteen pilot reports were part of this year's Main Estimates exercise. We continue to place emphasis on quality-of-service initiatives, a major component of which is the development of service standards in consultation with clients and citizens.*
- *Continuity in leadership and persistence in moving forward. We are addressing this partially through the La Relève initiative and programs to replenish and develop the leadership cadre of the public service; the President of the Treasury Board has established an Advisory Committee of private, voluntary and labour sector representatives to advise him on executive compensation issues; and action plans for the implementation of the deputy minister task forces have been developed. We recognize that change requires persistence and we are fully prepared to provide that commitment "over the long haul".*
- *Two recent publications that deal with many of these issues may be of interest to readers. They are "Getting Government Right: Governing for Canadians" (February 20, 1997) and "The Fourth Annual Report to the Prime Minister on the Public Service of Canada" (February 3, 1997).*

About the Study

Objective

This study was undertaken to draw to Parliament's attention some of the areas that we believe are particularly important to the continued well-being of the Canadian federal public service. This Office shares Parliament's interest in maintaining a competent and efficient federal public service that will serve Canadians well, now and in the future.

Approach and Methodology

The chapter is based on the results of discussions with some 125 executives and other individuals, mostly inside the public service. It is also based on the findings of other work carried out by our Office over time. It is further based on an extensive review of the public management literature, and consultations with researchers who work in the area of public administration. The study included focus group discussions, and meetings with provincial government officials, union executives and international practitioners.

Study Team

Alick Andrews
Otto Brodtrick
John Holmes
Jacques Goyer
John Mayne
Henno Moenting
Peter Simeoni
Glenn Wheeler

For information, please contact Maria Barrados, the responsible Assistant Auditor General.

Chapter 2

Financial Management: Developing a Capability Model

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Financial Management: Developing a Capability Model

Assistant Auditor General: Douglas G. Timmins

Responsible Auditor: Hugh A. McRoberts

Main Points

2.1 The environment within which the government is operating today is rapidly changing. The effects of limited resources, downsizing and delayering are placing greater demands on the government in providing services to Canadian taxpayers. Within this environment, the need for effective financial management has never been greater. Financial management plays a critical role in contributing to the government's achievement of its goals of reducing its costs and improving its financial position.

2.2 Despite the number of royal commissions, audits, studies and Treasury Board Secretariat initiatives over the years, achieving effective financial management in government organizations remains, in our view, a top priority that requires ongoing attention. With each Report of the Auditor General, we continue to observe and report to Parliament on significant problems, across a broad range of government operations, that occur as a consequence of failings in financial management.

2.3 These issues represent, in our view, a continuing basis of concern and raise important questions about the state of financial management in the government. Not the least of these is the question of whether our observations represent the type of failings that result from doing business in any large organization, or are symptomatic of more systemic problems in financial management. Additionally, some ministers continue to express to our Office their concern and frustration over the lack of appropriate financial information to support strategic decision making.

2.4 The Office of the Auditor General has had, as a long-standing strategic priority, the goals of encouraging better financial management within the federal government and improving the understanding of the role that financial management can and should play. It is for this reason that, in conjunction with the Treasury Board Secretariat, we have initiated this study. The objective of this study is to build on existing work to develop a modern framework that will describe key elements needed for effective financial management and that will provide a basis for assessing the state of financial management within departments and agencies.

2.5 This chapter is the first stage of a study designed to respond to the need for a revitalized financial management framework. It is intended to provide a basis for discussion among central agencies, departments and our Office. Once complete, the study will provide an agreed-upon framework to assess financial management capabilities and to improve the effectiveness of financial management in the federal government.

2.6 We are very encouraged by the recent initiative of the President of the Treasury Board in establishing an Independent Review Panel on Modernization of Comptrollership in the Government of Canada. The Office supports the work of the Panel, and we will take the results of its work into account as this study proceeds.

Introduction

The Purpose of This Chapter

“I have agreed to work with Treasury Board and the senior financial community to help make financial management more effective. This will include developing a framework of financial management and control standards, assessing the current state of financial management against these standards, determining the skill and experience requirements of financial staff, and helping develop specific measures to advance the state of financial management control.”

*November 1995 Report of the
Auditor General of Canada*

2.7 We have begun, in consultation with the Treasury Board Secretariat, a study of financial management in the federal government. The ultimate objective of the study is to develop a model of financial management that will permit us, the Treasury Board Secretariat and departmental managers to assess the financial management capability of departments against an agreed-upon standard.

2.8 This chapter represents the first step in that process. In this chapter, we briefly review some of the factors that have led us to undertake this endeavour. Second, we set out the scope of the project and propose a definition of financial management and its objectives in the government context by way of a Financial Management Activity Model. Third, we propose an approach to developing a methodology for assessing financial management capability. This methodology is based on an adaptation of the Software Engineering Institute’s Capability Maturity Model, which was developed by it to assess software development firms. We believe that this approach can be successfully applied to create a Financial Management Capability Model.

2.9 At the end of this chapter, we indicate the steps in the development process that will need to be followed from here. Critical among these is widespread consultation with financial and operational managers throughout government. This step is important both to take advantage of their wisdom and experience as we develop the Model and to help ensure that it is widely accepted by the financial community once it has been completed. The ideas in this chapter are not being presented as the final word. Rather, we hope that these ideas are seen as a first word and provide the basis for future discussion. Further information on the study’s objectives can be found at the end of the chapter in the section **About the Study**.

Why This Study?

A long-standing concern

2.10 Despite a number of royal commissions, audits, studies and Treasury Board Secretariat initiatives over the years, achieving effective financial management across government organizations remains, in our view, a top priority that continues to require senior management attention. The effectiveness of financial management still varies among organizations and often within an organization over time.

2.11 The Office of the Auditor General continues to observe and report on significant problems, across a broad range of government operations, that occur as a consequence of failings in financial management practices. Examples include:

- a lack of financial information for managing resources and controlling costs, which results in decisions being made without knowing the financial consequences of those decisions. Illustrations of this weakness were reported in Chapter 17 of our September 1996 Report, “Human Resources Development Canada - Canada Pension Plan: Disability” and in Chapter 32 of our November 1996 Report, “Canadian Heritage - Parks Canada: Management of Historic Canals”;
- instances of insufficient involvement of senior financial officers in important decisions, with significant operational and financial implications. An illustration of the consequences of this weakness was reported in Chapter 15 of our 1993 Report, “Department of Fisheries and Oceans: Northern Cod Adjustment and Recovery Program”;
- inadequate information for management of fixed assets, which results in excess inventory. The estimated cost savings of eliminating unnecessary inventory could be up to \$1.25 billion. This example was reported in Chapter 23 of our November 1996 Report, “Materiel Management in the Federal Government”; and
- inadequate activity-based management information to support the determination of user fees. An illustration of the impact of this issue was reported in Chapter 32 of our November 1996 Report, “Canadian Heritage - Parks Canada: Management of Historic Canals”.

2.12 These observations and many others raise questions concerning the strength of financial management in the federal government. For instance:

- Are financial controls adequate?
- Do managers fully understand what government programs/services cost?
- Do ministers and deputy ministers have the financial information, advice and support they need for decision making and for meeting their obligations to account for the use of public money?
- Are accountability relationships clearly established and understood so that managers are held to account for the financial impact of their decisions?
- Does the management culture within the federal government understand, value and recognize the important role that financial management can and should play in assisting departments to achieve their objectives?
- Do the consequences flowing from failures in financial management provide an incentive for managers to pay attention to these issues?
- Are there impediments to effective comptrollership within the federal government?

Increased demand for financial information

2.13 Increasingly, there is a demand for complete, accurate and timely financial information that, when combined with meaningful performance information, allows management and parliamentarians to put the cost of government programs in perspective. Some ministers have expressed to our Office their concern and frustration over the lack of appropriate financial information to support strategic decision making.

2.14 Similarly, as government moves to alternative forms of service delivery, the demand for reliable financial and performance information to support strategic decision making is expected to increase. Both financial and performance information will increasingly be required to support such decisions as the implementation of user fees to recover costs or to assess alternative program delivery strategies.

Systemic weaknesses or isolated instances?

2.15 Consideration of this issue raises one further question. Do the observations noted above signal serious systemic weaknesses in the structure of financial management, or are they merely isolated instances? On the one hand, if one judges the financial management capability of the government solely by the reports of financial management failings, then one could be led to be concerned. On the other hand, the Government of Canada is a very large organization in which many important financial management decisions are made every day. Viewed in this context, one could reasonably expect that even in an organization in which the overall level of financial management is satisfactory, a certain number of bad decisions could be made. This study is intended to provide a perspective that will permit us to put our observations in context and respond to the questions posed.

2.16 **Current assessment.** The *Financial Administration Act*, Treasury Board policies and Receiver General directives have established at great length, and often in great detail, the standards for financial management in the federal government. To date, financial management activities in departments and agencies have largely focussed on complying with directives from central agencies, adhering to control processes and ensuring that resources are used in compliance with legislative authorities.

2.17 In essence, many organizations have employed a largely mechanical approach to financial management functions. Although this approach may ensure that these functions are performed in accordance with established directives, it does not ensure that operational managers recognize and understand their broader financial management responsibilities. Similarly, this approach does not ensure that financial management activities become integrated into departmental operations and assist the organization in achieving its intended results at “reasonable” cost in terms of human, technical and financial resources. Nor does this approach enable the function to place the financial implications of decisions, directives or policies front and centre for management to consider. In other words, at the point where an organization makes significant operational decisions, financial management staff are not routinely asked to provide the analysis and advice for senior management to assess the financial consequences of these decisions.

2.18 To date, the effectiveness of financial management within government organizations has rested, to a large extent, on the strength, willpower and initiatives of individual senior financial officers. Yet such initiatives have not always been sustainable after those individuals have left the organization. In other words, an individual’s initiatives are often not enough to “institutionalize” effective financial management within an organization.

2.19 In discussions with Treasury Board Secretariat officials, we agreed that based on the evidence currently available, neither we nor they could reliably answer the questions raised. At the same time, we agreed that more knowledge is essential to be able to put in perspective the failures in financial control that came to our attention, to provide a systematic basis for improving the quality of financial management, and to be able to provide information to Parliament on the control of the public purse. The purpose of this study is to develop a methodology that will permit a systematic assessment of the financial management capabilities of departments and agencies.

Developing a new approach

2.20 In order to put financial management issues in perspective, the Office of the Auditor General would like to be able to draw broad conclusions on the government’s financial management capability. However, existing assessment methodologies have tended to follow a piecemeal approach — focussing on analyzing only particular aspects of financial management. They do not provide an analysis or assessment of the general state of financial management in the federal government. Although existing methodologies include criteria for effective financial management, they do not provide a tool for organizations to determine what type or level of financial management they need. Nor do they provide guidance to organizations on how to improve financial management functions, where necessary.

2.21 Additionally, most of the existing approaches to assessing financial management have their origins in the private sector and tend to emphasize issues, concerns and expectations more appropriate to that environment than to the ongoing realities of public sector management. Put simply, in the private sector, management spends money in order to generate money. The measures used to monitor money spent versus money generated, such as net profit, return on investment and increased share values, are key performance indicators for managers that are closely monitored by them on an ongoing basis.

2.22 In the public sector, money is raised through taxes so that it can be spent to achieve the objectives of the government. For the public sector manager, money is one of several resources that are blended and brought to bear on program objectives. As such, financial information acts much like a fuel gauge — something to be consulted occasionally, and more often near the end of the trip to be sure that there will be enough fuel left to make it to the gas station. The more important information for the public sector manager relates the costs of program delivery to the degree of objective attainment. This information is more difficult to create and, if it were available, could be obtained only occasionally. All of this means that financial management in the private sector and public sector takes on very different forms and appearances. Although the forms may occasionally provide a comforting sense of familiarity looking from one sector to the other, their content is often significantly different.

2.23 Finally, the piecemeal approach to assessing financial management ignores the interrelationships of financial management and other components of organizational control, which together are essential for overall effective management of an organization. We believe that understanding these relationships is critical. Good financial management is more than just the sum of the pieces.

2.24 In saying this, it is not our intent to dismiss the work that has been done. The issues raised are important. Rather, our intent is to build upon the existing work and to give it a structure that will meet current needs.

New approaches to control models

2.25 The impact of technology and the flattening of the traditional organizational pyramid structure demand more reliance on control through informal means such as shared values, shared vision and open communication. As a result, in today's business environment, the term "control" has sometimes taken on a broader meaning than just internal control over transactions and financial reporting. This growing (and possibly necessary) reliance on informal controls, based on shared values and effective communication, is important in compensating for reductions in formal checks and balances. Additionally, these changes have placed increasing importance on strong and clear accountability arrangements supported by systems that will produce valid and timely information on results.

2.26 In response to this trend, the Canadian Institute of Chartered Accountants (CICA) established the Criteria of Control Board (CoCo). Its role is to provide guidance to organizations on designing, assessing and reporting on their control systems. This guidance reflects the broader concept of control as a key element of good management. It describes and defines control in a manner that goes beyond traditional internal accounting controls. It also includes criteria for overall effective control in an organization, which includes the achievement of results and the financial performance associated with achieving these results.

2.27 Similar guidance has also been developed and issued by other professional bodies, for example: Internal Control - Integrated Framework, issued by the Committee of Sponsoring Organizations of the Treadway Commission in the United States; and the Cadbury report, issued in the United Kingdom.

2.28 All of these concerns and trends, together with the changing nature of government, indicate a need for a revitalized framework for financial management. The framework being proposed in this study is intended to recognize the role of financial management within the broader concepts of organizational control.

Initiatives to Improve Financial Management

2.29 The Office of the Auditor General has set, as a long-standing strategic priority, the goals of influencing the quality of financial management and control within the federal government and improving the understanding of the role that financial management can and should play.

2.30 As discussed earlier, our concern led us to our decision to work together with the Treasury Board Secretariat to begin the present study. We believe that, as part of moving forward, our Office and the government need baseline information about departments' financial management capability. This study is a first step in getting that information. As the study progresses, and as resources become available, the Treasury Board Secretariat has indicated its desire to be more closely involved in this project. We welcome this co-operation.

2.31 The President of the Treasury Board has created an Independent Review Panel on Modernization of Comptrollership. Its task is to review and report on how the comptrollership function should evolve to reflect the changing business and operating needs of the government. The Panel was created because of the profound changes the government is undergoing in how it operates, the resources available to it, and the challenges, risks and opportunities facing it. The Panel's work is considered to be pivotal in helping government deliver on its commitment to provide more effective financial management. The Panel has indicated it will consult broadly on key aspects of comptrollership, including:

- financial management;
- accountability and performance reporting;
- audits and reviews; and
- related areas such as financial information and public sector management.

2.32 We have been informed that the decision to establish a high-profile Panel like this reflects the seriousness with which Treasury Board Secretariat officials view the concerns that we have raised about financial management. The Office is committed to working with the Independent Panel and the Treasury Board Secretariat in achieving better financial management in the Government of Canada. The Panel's report will be taken into account as this study progresses. We will be interested in seeing the extent to which the Panel addresses the questions raised in paragraph 2.12.

Developing a Financial Management Model

Defining Financial Management

2.33 Experience has shown that financial management is a term that has almost as many meanings as there are people who use it. Indeed, the lack of clarity about what the term encompasses has probably contributed to the difficulties in making progress in the area over the years. Accordingly, we have begun our study by suggesting a definition of financial management in terms of the activities that we believe it includes. In the private sector, financial management is often thought of as including two areas of activity frequently covered by the terms "treasury" and "comptrollership". In government, the activities usually associated with the treasury function, such as cash flow management, debt management, investment and corporate budgeting, are carried out jointly by central agencies – the Department of Finance, Receiver General and the Treasury Board Secretariat. Our current study excludes these activities from its scope. Thus our definition of financial management is intended to refer only to

those financial management activities that are carried out in the departments and agencies of the government. We have also excluded, at this time, the issues of financial management in Crown corporations.

2.34 Financial management in departments and agencies is an important component of what financial and program managers do in delivering programs within their organizations. Specifically, in carrying out their financial management responsibilities, the managers' role is to:

- identify and manage financial risks;
- have available, on a timely basis, relevant, accurate and reliable information that allows them to understand the financial implications of decisions before making them;
- report on financial and operational results (see Chapter 3 for a current assessment of the central accounting function); and
- protect against fraud, financial negligence, violation of financial rules or principles, and losses of assets or public money.

2.35 Effective financial management is therefore a critical activity that helps an organization assess the cost of achieving its objectives, account for the results of its operations and discharge its accountability obligations.

2.36 The essential activities and components of financial management are illustrated in Exhibit 2.1, the Financial Management Activity Model. While not specifically set out in the Exhibit, the Activity Model also includes the informal controls and practices that are essential components of the overall management framework and hence can have a critical effect on how financial management will function in a particular organization. These components include:

- organizational environment;
- human resources policies and practices; and
- communication practices through which the organization's objectives and purposes are communicated.

Exhibit 2.1

(This exhibit is not available, see the Report)

2.37 There are several key processes that underlie the Financial Management Activity Model. They include:

- the expenditure and revenue cycles;
- cost accounting;
- payroll and benefits accounting;
- providing support for performance measurement and reporting;
- financial reporting;
- financial planning and budgeting; and

- asset and liability management.

2.38 The responsibility for these processes and functions is not restricted to departmental financial managers. Some of the responsibility will also extend to departmental operational and program managers, depending on the nature of the department.

2.39 Exhibit 2.2 extends the Financial Management Activity Model by illustrating how the activities and components of financial management are related to the specific objectives of financial management, which in turn link to the broader objectives of financial management:

- managing financial risks;
- serving accountability; and
- supporting operational decisions.

Exhibit 2.2

(This exhibit is not available, see the Report)

Study Approach

2.40 This study is designed to respond to the need that we and the Treasury Board Secretariat have identified for a methodology that will permit us to reliably assess the financial management capability of departments and agencies.

2.41 In developing this financial management framework, we intend to work co-operatively with the Treasury Board Secretariat and the government financial community and to implement a process that incorporates extensive consultation with the management teams within departments and agencies.

2.42 As part of this study, we are developing a Financial Management Capability Model that will describe key elements needed for effective financial management and control. The Model, described in more detail below, is not intended to provide a definitive answer on the expectations for financial management in departments. Nor does it prescribe a complete approach for assessing financial management. Rather, it is intended to provide a basis for beginning discussions and developing consensus on the essential components of effective financial management.

Principles underlying our work

2.43 The main principles underlying this study are the following:

- Financial management, working in concert with other components of an effective management framework, should be used to assist organizations in achieving their objectives and accounting for the cost of the results of their operations.
- Management should be responsible both for determining the appropriate level of financial management capability for its organization and for establishing the necessary processes and practices needed to achieve and maintain this capability.
- Not every organization requires the same level of financial management capability. The appropriate level should be commensurate with the nature and complexity of the organization and the risks to which it may be exposed. We recognize that “no one size fits all”.

- Financial management activities must be cost-effective. In other words, the cost of maintaining control should be commensurate with the risk the controls are intended to address.

The Financial Management Capability Model

2.44 The purpose of the proposed Capability Model is to provide a tool that a government organization can use to:

- determine its financial management requirements based on the nature, complexity and associated risks of its operations;
- assess its financial management capabilities against established requirements; and
- identify any gaps between what the organization requires and what it is capable of, in terms of financial management. Having identified these gaps, an organization can then address any significant imbalance between its requirements and its capabilities and, subsequently, work toward developing the appropriate level of financial management capability.

2.45 As the size or complexity of an organization or the risk associated with its activities increases, so does the need for more sophisticated financial management capabilities. The proposed Model will set out an evolutionary path that an organization can follow in developing more sophisticated financial management practices, if necessary. It will also show the steps needed to progress from a level of financial management typical of a start-up organization to strong, effective financial management practices associated with a more mature and complex organization.

2.46 An important first step in addressing financial management issues is to treat the entire financial management function as a set of integrated business processes that support the people working in the organization in the achievement of its objectives. These processes, when properly performed, yield an appropriate degree or level of financial control. Clearly, a fully effective financial management framework must consider the relationships of all the required tasks, the tools and methods used, and the skills, training and motivation of the people involved.

2.47 The Model being developed proposes to establish a framework for strengthening financial management based on many small evolutionary steps. These steps have been organized into five progressive “capability levels”. To achieve a level of capability, an organization would be expected to satisfy all the requirements of that level and any preceding levels. As depicted in Exhibit 2.3, the five levels of capability proposed are:

- start-up;
- financial control;
- enhanced financial control;
- financial management; and
- enhanced financial management.

Exhibit 2.3

(This exhibit is not available, see the Report)

2.48 We have proposed these levels because we believe they:

- represent reasonable steps or building blocks that allow an organization to progress toward its appropriate level of financial management capability;
- suggest interim goals for improving financial management; and
- highlight immediate priorities for correcting any imbalance between an organization's financial management requirements and its actual capabilities.

Characteristics of the Capability Model

2.49 The Capability Model is being designed to be descriptive — not prescriptive. When completed, it will not tell an organization how to improve its financial management practices. Rather it will suggest what will be needed to achieve a certain level of capability. The Model is intended to set out a path for making the needed improvements by defining the financial management requirements for each level.

2.50 The Model will provide a framework for both determining the financial management requirements of an organization and comparing those requirements with the organization's actual capabilities.

2.51 In addition, the Model should reflect specific attributes or financial management capabilities that an organization at a particular level would typically exhibit. An organization could be assessed against these attributes to determine where it is on the financial management continuum according to the Model. While at a lower level on the capability framework, an organization may demonstrate some of the characteristics associated with a higher level of capability.

2.52 In summary, the incremental improvements or practices at each level of the Model are seen as the building blocks that allow an organization to establish effective financial management, and provide guidance for continuous improvement.

The Five Proposed Capability Levels

2.53 Each level will profile different capabilities in each of the key components or activities of financial management illustrated in the Financial Management Activity Model (Exhibit 2.1).

Start-up level

2.54 The start-up level describes the financial management characteristics of a new organization or program that has not yet established its key policies, practices and controls. Accordingly, this level, unlike the others, would not be viewed as a stable environment in which an organization or a program would wish to remain. Any accomplishments in establishing controls to contribute to the achievement of objectives, or the achievement of the objectives themselves, depend on the often isolated efforts of specific individuals, and there is no certainty that those accomplishments would be repeatable. An organization that has experienced dramatic changes in its operations — for example, amalgamation with another department or the relocation of operations — may also be at the start-up level of its financial management capability if it does not effectively manage the increased risks associated with the change.

Financial control level

2.55 The requirement for departments and agencies to comply with central agency practices and procedures for producing the Public Accounts of Canada and to meet the requirements of the Central Accounting System should ensure that most departments are able to maintain, on a consistent basis, a financial control framework. This control framework would represent the minimum requirements to satisfy the *Financial Administration Act*, Treasury Board policies and Receiver General directives.

2.56 Organizations at this level would be fully capable of processing their accounts payable. They would have begun to establish accounts receivable systems. Planning would largely be geared toward obtaining approval of appropriations and complying with Treasury Board's minimum requirements, that is, the Business Plan and Part III of the Estimates. Financial information would be historically oriented rather than future-oriented. Control efforts would focus on remaining within the vote and not allowing funds to lapse.

2.57 At this level, organizations' financial management capabilities would primarily be focussed on meeting the requirements of the Central Accounting System in order to have transactions processed.

Enhanced financial control level

2.58 At the enhanced financial control level, an organization's control processes would normally have been tailored to suit its needs, as opposed to only satisfying minimum requirements. There would also be an expectation that a risk-based approach to installing controls would be in place, with the focus on making them cost-effective. Accounts payable and receivables, if applicable, would be well managed and there would be control over assets and liabilities. Management would receive historical financial information on a timely basis. Analytical information would be produced as necessary, and not as part of routine financial reporting. Planning and budgeting processes would be working properly, and the organization may occasionally generate future-oriented information for decision making.

2.59 Since analytical information would not be routinely generated at this level, an organization's ability to make cost-effective decisions may be affected.

Financial management and enhanced financial management levels

2.60 An organization at one of these levels would be expected to be capable of maintaining effective financial control. It would routinely produce quantitative information for decision making (results would be reported and measured in terms of their effectiveness). At the financial management level, the organization would have started to recognize and implement concepts inherent to effective financial management, such as activity-based costing, benchmarking and performance measurement. However, there would still be room to improve the financial control and financial system advice and integrate or institutionalize financial management throughout the organization. This integration would involve linking finance more closely with program operations.

2.61 The enhanced financial management level would represent a fully capable organization where financial management and control would be fully integrated with departmental operations. A financial management culture, as well as a process for measuring whether the organization has achieved its objectives and the cost of doing so, would have been firmly established throughout the organization.

2.62 At these levels there would be a well-established process, such as a strong internal audit function, for providing assurance to management that the organization is operating as it should.

Using the Capability Model

2.63 In keeping with the principle that managers are responsible for financial management, we would expect that the use of the proposed Capability Model, once fully developed, would follow the pattern set out in Exhibit 2.4. As a first step, we would expect that the senior management of an organization would systematically analyze the cost and effectiveness of each key activity. The purpose of this analysis would be for management to determine three things:

- what financial risks it faces and which ones must be controlled;
- what financial information the organization needs to meet both internal and external accountability requirements; and
- what financial information it needs to support its operational and policy responsibilities.

Exhibit 2.4

(This exhibit is not available, see the Report)

2.64 The second step would be for management to determine, based on the results of its assessment, the level of financial management capability it needs to meet its responsibilities. This step would establish the required level of financial management capability for the organization in light of its responsibilities. That level would be expected to vary substantially among departments and agencies. For some (mainly small agencies whose major financial activities focus on payroll), the basic financial control level of capability might be sufficient. However, organizations with operations involving largely expenditures and policy formation might well find that they require an enhanced financial control capability. The largest and most complex organizations may determine that they need to attain the financial management or enhanced financial management levels.

2.65 As shown in Exhibit 2.4, the third step would be for management to assess the organization's capability in each process area. This assessment would likely involve a combination of traditional internal audit and review procedures and self-assessment of controls.

2.66 If the assessment process reveals a discrepancy between the necessary level of capability and the actual level, management would be expected to review its earlier analysis to determine whether the discrepancy is the result of either a deficiency needing to be remedied or an overstatement of the required capability. In either instance, the discrepancy would need to be resolved.

2.67 Auditors can also use the Capability Model and the process to assess an organization's level of financial management capability relative to its requirements. As development of the Model proceeds, assessment tools and guidelines will be developed to support an assessment process.

A Process of Consultation

2.68 In developing the Financial Management Capability Model, we recognize that *how* we will achieve our objectives is as important as achieving the objectives themselves. To this end, a critical component of our work will be extensive consultation with central agencies and financial and operational managers.

2.69 All these efforts are intended to provide input to the proposed Model, to assist in developing a consensus on the framework and, ultimately, to contribute to the achievement of effective financial management within the federal government.

2.70 We intend to carry out this study in several stages. The first stage, represented by this chapter, was to develop the basic elements of a model at a fairly high level of abstraction, and to put that work out for discussion with public servants, parliamentarians, and other interested parties. The second stage will be to elaborate the basic model by setting out for each of the process areas in the Activity Model the capabilities expected at each level of the Capability Model. Again, the results of this work will be the basis of consultations. The third stage will be to develop detailed assessment criteria and to validate them in selected departments. Finally, in conjunction with the Treasury Board Secretariat and departments, we can begin to apply the Model to do capability assessments and to continually refine the Model to improve the effectiveness of financial management in the federal government.

2.71 Our ultimate objective is to be able to assess financial management capability, both to identify areas where improvement will be needed and to be able to place in their proper context the failures in financial management that our Office observes from time to time. We believe that doing this will enable us to meet our objective of encouraging better financial management and to serve both Parliament and the public service better.

***Treasury Board Secretariat's comments:** The government notes the progress being made in developing a model to determine requirements and assess capabilities in financial management in departments. However, as explained in the chapter, in view of the profound changes the government is undergoing in how it operates, the resources available to it, and the challenges, risks and opportunities it faces, an Independent Review Panel on Comptrollership has recently been established that will review and make recommendations on the comptrollership function within the government. The government will wish to consider the recommendations from the Independent Review Panel before committing to implementation of such a model.*

About the Study

Objectives

The focus of this study is the financial management and control activities of departments and agencies.

In carrying out this study, our Office, in conjunction with departments and central agencies, wants to develop:

- a common understanding of what is meant by financial management in government organizations (to date, any consensus has been only at a very high level);
- a basis for creating and institutionalizing an effective financial management model, with input and feedback from financial and operational managers; and
- a new, systematic method that could be used to assess the general state of financial management in government and to provide organizations with guidance for improvement.

Study Team

P. Elaine Grout–Brown
Christine S. Kelly
Joyce C.S. Ku
Bruce C. Sloan

For information, please contact Hugh McRoberts, the responsible auditor.

Chapter 3

Management of the Government's Accounting Function: A Central Agency Perspective

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Management of the Government's Accounting Function: A Central Agency Perspective

Assistant Auditor General: Ron Thompson

Responsible Auditor: John Hodgins

Main Points

3.1 The accounting function provides essential information for managing the government and for reporting financial results to Parliament, Canadians and other interested parties.

3.2 Although the accounting systems are out-of-date technically, they continue to produce annual financial statements for the government that are credible, understandable and useful. In fact, in the past decade the function has undergone significant improvements and efficiencies that have, among other things, placed Canada at the forefront internationally in this type of reporting.

3.3 However, the ability of the accounting function to analyze and interpret financial information throughout the year needs to be strengthened in order to forecast financial results of that year and budget figures for the following year.

3.4 In response to these needs, the government is making extensive changes to its accounting function by implementing a Financial Information Strategy. The Strategy should help modernize and strengthen the accounting function. While we agree with the changes being undertaken through the Strategy, we believe that more is needed.

3.5 Specifically, we believe that the government should prepare and publish its financial reports in a more timely fashion, and consider other strategies to enhance the usefulness and credibility of its monthly or quarterly reports.

3.6 In view of the significant changes under way and planned, we continue to believe that the government should amalgamate its central accounting function and take immediate steps to assess the capability of accounting groups within departments and agencies to implement new systems and accrual accounting.

3.7 The government has established an Independent Panel on Modernizing Comptrollership in the Government of Canada. The Panel may wish to consider our findings and recommendations as part of its work.

Introduction

Why is accounting important?

3.8 Most organizations account for their activities and financial transactions in one way or another. For individuals, accounting data can also be extremely important. Whether purchasing a home and taking out a mortgage, or budgeting for groceries, we need to know our current income and past spending patterns in order to carry out sound financial planning. The more complete and consistent our personal accounting information, the more informed our financial decisions will be, and the more reliable our financial forecasts.

3.9 In the business world, an annual report and financial statements provide a concise overview of a company's activities and financial performance. This information is extremely important to current and potential shareholders in deciding whether to buy or sell the company's stock. For management, accounting information helps in assessing which business lines should be promoted or cut back and what other actions are needed to increase overall corporate net worth.

3.10 Similarly, in the public sector, annual reports and summary financial statements help users understand the overall size of governments; the nature, scope, financing, costs and impacts of their activities; and the extent to which targets for overall revenues, spending and borrowing have been met.

3.11 In government, accounting information enables legislators to hold governments accountable for their actions, both at the program level and in the aggregate. Chapter 5, "Reporting Performance in the Expenditure Management System", deals with reporting on what programs are achieving. But it is not enough to know what each program of government is achieving, without knowing whether the aggregate of all programs is financially sustainable.

3.12 Accounting information provides both an historical overview of where a government stands financially at a point in time and a tool for predicting the future. In this respect, users need to have confidence in their government's accounting information. Lack of confidence, for whatever reason, could cause economic malaise, such as disproportionate fluctuations in the value of a nation's currency or in interest rates.

3.13 In summary, accounting information is an important part of the accountability and communication process for both individuals and organizations, including government, in determining and evaluating financial health.

The purpose of this study

3.14 The purpose of this study was to inform members of Parliament about the importance and quality of the government's accounting function and the significant challenges it faces, and to identify concerns and make recommendations to improve the function.

3.15 When considering the government's accounting function, one can look at information at two levels — for the government overall and for each of its departments, agencies and Crown corporations. Both levels of information are important. However, this chapter addresses information only at the overall government level, that is, from a central agency perspective.

3.16 At the departmental level, the Office of the Auditor General, in conjunction with the Treasury Board Secretariat, is developing a Financial Management Capability Model. The Model should permit an organization to compare its financial management requirements with its capabilities. The process for developing and using

departmental and agency accounting information is part of the Model. An overview is included in Chapter 2, “Financial Management: Developing A Capability Model”.

3.17 The findings and conclusion presented in this chapter are based on a review of the central agencies’ roles and responsibilities, interviews with government officials responsible for the central accounting function, and interviews with officials in private sector companies, provincial governments and other national governments. We also researched existing literature on the subject. Further details on the study are presented at the end of the chapter in **About the Study**.

What are the characteristics of a good accounting function?

3.18 An accounting function comprises many things. It includes the organization’s accounting rules, normally referred to as generally accepted accounting principles. In the private sector, those principles are established by the Accounting Standards Board of the Canadian Institute of Chartered Accountants, while for governments in Canada they are being developed by that Institute’s Public Sector Accounting and Auditing Board. The accounting function also includes accounting procedures or methods of applying those principles, the actual accounting records and the accounting system that produces those records, and the reports, such as financial statements, generated from the accounting records.

3.19 Above all else, the accounting function includes people, who make all of this happen and who explain the numbers and use them to support decisions with financial analysis, anticipate problems and recommend corrective action.

3.20 A good accounting function normally has the following interconnected characteristics:

- It produces **credible** financial information that is **understandable**, **useful**, and available on a **timely** basis.
- The financial information is subjected to **analysis** by the people in the accounting function, with resultant advice integrated into the decision-making process.
- The financial information is assembled with **efficiency**, using technology to the greatest extent possible.

3.21 We have ascertained these characteristics from the Canadian Institute of Chartered Accountants’ Handbook and guidance by similar professional organizations worldwide, from accounting literature, and from discussions with accounting and auditing professionals both within Canada and abroad. Each of these characteristics is explained in the following paragraphs.

3.22 **Credible.** Financial information produced by the accounting function, both for internal use and for publication externally, should reflect financial reality. Put simply, users must be able to believe it. Credible financial information is achieved through the consistent application of generally accepted accounting principles. Credibility is also evidenced through an opinion, without qualification or reservation, from an independent auditor. Generally accepted accounting principles provide objective standards of good accounting and reporting practice that organizations can use to prepare their financial statements and that auditors can use to assess them.

3.23 **Understandable.** The financial information produced by the accounting function should be concise, succinct and crafted in a way that users with a reasonable knowledge of the organization can understand. It should contain enough information for analysis, but not too much detail. In other words, users should not be intimidated by massive amounts of detail when they simply need a financial overview. However, because more detailed information is often required, the accounting function should provide a trail to the source of that information.

3.24 Useful. User-friendly indicators of financial health can help readers of government financial statements recognize the significance of the very large numbers shown. In the private sector, “earnings per share” and “debt-to-equity” ratios have evolved over time to make summary financial information useful. In government, the Canadian Institute of Chartered Accountants is researching indicators for this purpose; results of this research are expected soon.

3.25 Timely. To have a chance of making a difference or influencing events, sound financial decisions must be made as soon as possible after problems are identified. The financial information produced by the accounting function should therefore be made available, in final form, as soon as possible after the reporting period ends, taking into account the costs of doing so.

3.26 Analysis. Good accounting functions should be integrated into management decision making. With the advances in technology, transaction processing requires less manual intervention, thereby freeing up accounting resources to analyze and interpret financial information and to make recommendations to management. Increasingly, accounting functions are more focussed on the future than on the past.

3.27 Efficiency. Financial information should be accumulated and reported as quickly and economically as possible, and should be capable of timely use for analytical purposes. Little time should be required to process period-end adjustments. Resources in the accounting function can thus devote more time to analysis and advice.

3.28 In this chapter, we assess the government’s present accounting function against these characteristics. As noted, the government does well in certain areas and not so well in others; however, actions are under way to strengthen areas where improvement is required.

Study Findings

How Does the Government of Canada Do Its Accounting?

Accounting function framework

3.29 The Government of Canada’s central accounting function is shared by three entities: the Receiver General function in Public Works and Government Services Canada, the Treasury Board Secretariat and the Department of Finance. Exhibit 3.1 summarizes the overall framework for the accounting function in the Government of Canada.

Exhibit 3.1

(This exhibit is not available, see the Report)

3.30 The Receiver General is also the Minister of Public Works and Government Services Canada. The bulk of the activities in the central accounting function are carried out by the Receiver General function within that department. It maintains and operates the government-wide Central Accounting System. It establishes and communicates accounting procedures to departments, agencies and Crown corporations and provides guidance on their application. It also produces interim financial reports and the *Public Accounts of Canada*. The Central Accounting and Reporting Sector of the Receiver General function employs 82 accountants, systems specialists and operational managers.

3.31 The Treasury Board Secretariat establishes and communicates accounting policies to departments and agencies and provides guidance on their application. It provides direction to the Receiver General function on the form and content of the Public Accounts, establishes various accounting estimates, establishes the form and content

of the government’s financial statements and maintains liaison with the Office of the Auditor General. The Government Accounting Policy Division of the Treasury Board Secretariat carries out these responsibilities and employs six accountants.

3.32 The Department of Finance has broad responsibility for matters relating to the financial affairs of Canada. Along with several other responsibilities, the Fiscal Policy Division of the Department has the primary responsibility for analyzing and assessing the financial position of the government on an ongoing basis. Based on a summary of the cash transactions of the government produced by the Receiver General function, it prepares and publishes *The Fiscal Monitor* monthly. At year end, the Division produces the *Annual Financial Report of the Government of Canada*. In addition, it has joint responsibility with the Treasury Board Secretariat for the form and content of the Public Accounts. The Division employs 10 economists to fulfill these responsibilities.

3.33 Departments, agencies and Crown corporations are also key elements of the overall framework of the accounting function. Regularly, departments verify the completeness of the information contained in the Central Accounting System. Annually, they provide other accounting information to the Receiver General function for the preparation of the Public Accounts. Quarterly and annually, Crown corporations provide aggregate accounting information to the Receiver General function for reporting in the government’s financial statements.

Basis of accounting

3.34 The government prepares its monthly financial statements primarily on a “cash basis” and its annual financial statements on a “modified accrual” basis. Exhibit 3.2 provides a simple explanation of the difference between these two bases of accounting and how the government proposes to prepare financial statements in the future.

Exhibit 3.1

(This exhibit is not available, see the Report)

Exhibit 3.2

Basis of Accounting

CURRENT PRACTICE		PROPOSED PRACTICE
Monthly	Annually	Monthly and Annually
Cash receipts	Cash receipts and non–tax accounts receivable for amounts owing to the government	Cash receipts and both tax and non–tax accounts receivable for amounts owing to the government
<u>less</u>	<u>less</u>	<u>less</u>
payments and adjustments to accounting estimates	payments and accounts payable for amounts owing by the government	payments and accounts payable for amounts owing by the government
= <i>cash basis of accounting</i>	= <i>modified accrual basis of accounting</i>	= <i>accrual basis of accounting*</i>

* As described later in this chapter, the government is also proposing to implement full accrual accounting for capital assets.

Accounting process

3.35 At a very simplified level, the accounting process of the government is depicted in Exhibit 3.3.

Exhibit 3.3

(This exhibit is not available, see the Report)

3.36 Departments submit accounting transactions on a cash basis of accounting to the Central Accounting System, which is a 30-year-old aggregate of computer applications that are maintained and operated by the Receiver General function. The input to the System is done using a variety of media ranging from paper batches to more modern means, such as on-line transmissions.

3.37 The Receiver General function prepares a set of monthly financial statements primarily on a cash basis of accounting approximately five weeks after month end. To accomplish this, staff process an average of 100 manual journal entries each month after investigating, among other issues, transaction coding errors made by departments and agencies. The Department of Finance analyzes those financial statements and publishes them in *The Fiscal Monitor*. This publication explains the government's performance compared with the previous year's results for the same period.

3.38 For year-end reporting, the Receiver General function accumulates information on liabilities, values of assets and accounts receivable in addition to the cash data produced in the monthly process. This takes six to seven months to complete. To produce the financial statements and accompanying notes, detailed information must be obtained from departments, agencies and Crown corporations. As a result, more manual journal entries than at month end are required to produce the government's financial statements on a modified accrual basis.

3.39 The financial statements are included in Volume I, Section 1 of the *Public Accounts of Canada*. A condensed version of the government's financial statements is also published in the *Annual Financial Report of the Government of Canada*.

3.40 In summary, the existing overall framework for the accounting function of the Government of Canada requires a central set of detailed accounting records, fed by transactions submitted by individual departments, agencies and Crown corporations that do little else in the way of overall government accounting. As explained in more detail later in the chapter, this framework is undergoing a fundamental change.

3.41 **Our observations.** The overall framework, basis of accounting and accounting process shown in Exhibits 3.1, 3.2 and 3.3 have significantly improved in the past decade. In particular, credibility has improved as the government has adopted more generally accepted accounting principles, and the Auditor General has given a clean opinion on its annual financial statements for six of the past seven years. The government's financial statements are now much more understandable, useful and timely. Improved procedures have been implemented to better analyze why the numbers are what they are. And, particularly in the Receiver General function, overall improvements in efficiency have resulted in significant cost savings to the government. Nonetheless, in our view, improvements can still be made.

3.42 Exhibit 3.4 compares the government's present central accounting function with the characteristics of a well-performing function described earlier. The comparison is shown in two parts, broadly based on the three key outputs of the accounting function:

- *The Public Accounts of Canada and the Annual Financial Report.* These annual reports are of use primarily from a historical perspective. They report the government's financial position at the end of the year and why it improved or deteriorated over the year.
- *The Fiscal Monitor.* This monthly report, while of interest from an historical perspective, should be of more use for predicting the final results for the year and in establishing targets for the next year.

Exhibit 3.4

Comparison of the Government's Performance with the Characteristics of a Well-Performing Accounting Function

Characteristic	Historical	Predictive
Credible	√	
Understandable	√	√
Useful	√	
Timely		√
Analysis	√	
Efficiency		

3.43 In summary, the government's accounting function does a relatively good job presenting historical information. However, in our view, improvements can be made in presenting information for predictive purposes.

3.44 **Credible and useful.** The *Annual Financial Report of the Government of Canada* and *Public Accounts of Canada* include audited financial statements that are prepared for the most part in accordance with accounting principles recommended by the Public Sector Accounting and Auditing Board (modified accrual basis). The monthly issue of *The Fiscal Monitor*, however, is not prepared in accordance with those principles; it is prepared primarily on a cash basis. Therefore, as a predictive tool, we believe that the monthly financial reports are not particularly helpful. It is difficult to predict what the financial results of a particular year will be, or to prepare a budget for the subsequent year, when the most current financial information available has been prepared on a different basis of accounting.

3.45 To illustrate, Exhibit 3.5 compares the 1995-96 deficit announced in the 1995 Budget with the updated figures presented in the 1996 Budget, and with the preliminary figures as published in *The Fiscal Monitor* of March 1996 and finally published in the 1996 *Annual Financial Report of the Government of Canada* and *Public Accounts of Canada*.

Exhibit 3.5

Comparison of the Budget with Actual Figures for 1995-96

(\$ Billions)

	Original Budget	Updated Budget	March Fiscal Monitor	Annual Financial Report and Public Accounts
Revenues	133.2	130.6	128.5	130.3
Program spending	<u>-114.0</u>	<u>-113.8</u>	<u>-106.2</u>	<u>-112.0</u>
Operating balances	19.2	16.8	22.3	18.3

Public debt charges	<u>-49.5</u>	<u>-47.0</u>	<u>-46.6</u>	<u>-46.9</u>
Deficit	<u>-30.3*</u>	<u>-30.2*</u>	<u>-24.3</u>	<u>-28.6</u>
Published in	February 1995	March 1996	May 1996	October 1996

* The figure is presented without the \$2.5 billion contingency reserve.

3.46 Significant variations exist in these amounts. Although it is reasonable to expect variations between amounts forecast in the 1995 Budget and actual outcomes, one would expect forecast figures published just before the fiscal year end (in the 1996 Budget) and the actual figures published in the March 1996 issue of *The Fiscal Monitor* to be closer to the final outcomes. That issue of *The Fiscal Monitor* did note, however, that it did not present final results for 1995-96 and that the final deficit outcome would be affected by “end-of-year accounting adjustments,” which had ranged from \$3 billion to \$6.4 billion in recent years.

3.47 Another example demonstrates the problems associated with presenting financial information using the cash basis of accounting. The May 1995 issue of *The Fiscal Monitor* provided the following explanation for an increase in expenditures:

All of the increase in program spending was attributable to the timing of federal government employees’ pay periods. For the majority of federal government employees, pay periods are once every two weeks. As a result, there are three pay periods within one month twice during the course of the year. In 1995-96, the first three-pay period occurred in May 1995, whereas in 1994-95, it occurred in June 1994. This raised program spending by about \$.4 billion in May 1995.

3.48 Clearly, salary levels (and payroll costs) were unaffected by having three pay periods fall in one month, although the increase in reported expenditures for that month might indicate otherwise. Explanations such as this would be unnecessary under an accrual accounting regime as fluctuations of this nature would not occur.

3.49 Timely and useful. Annual financial information is available six to seven months after the fiscal year end. In our global economy, much can happen in a few months that can worsen a deteriorating financial position. In our view, earlier release of financial results could hasten the public discussion of ways to improve that position, particularly in this era of massive deficits and debt.

3.50 Analysis and efficiency. Although analysis of the monthly financial information is performed to find out why the numbers are what they are, less work is done to forecast what the financial results for the year will be and what corrections could be made. When most staff in the accounting function spend their time processing accounting transactions and writing journal entries, it is little wonder that more structured and forward-looking analysis is not being done. Such analysis is essential for anticipating problems and taking corrective action during the year, and for preparing realistic budget forecasts for the subsequent year.

3.51 Given the results of our comparison of the government’s accounting function with a well-performing accounting function, as summarized in Exhibit 3.4, one is likely to ask whether the government is taking action to overcome the deficiencies noted. Happily, the government intends to do so; however, as described in the next section, this will be a significant challenge.

Is the Government Changing How It Does Its Accounting?

3.52 The government has announced plans to implement four significant changes in its accounting systems and rules over the next five years. These changes, known as the Financial Information Strategy, should help modernize and strengthen the accounting function. They do, however, pose significant challenges for the government.

3.53 In addition, in November 1996, the Treasury Board President announced the creation of an Independent Panel on Modernizing Comptrollership in the Government of Canada, and the appointment of a Deputy Comptroller General. The Panel comprises public and private sector experts and its work will take into account comptrollership (including the accounting function) in both central agencies and operating departments of the government. Among other things, the Panel will consider the changes to comptrollership that will ensure that it provides value and support to management and Parliament and meets the needs of both.

Systems renewal

3.54 As noted previously, the government's Central Accounting System has been in place for over 30 years and is in need of modernization. The government plans to replace the Central Accounting System with a summary ledger, and separate accounting systems and detailed ledgers for each of its approximately 100 departments and agencies. Crown corporations, which are also included in the summary financial statements, already have these systems in place.

3.55 The government claims that this change in systems architecture, when fully implemented, will make individual departments and agencies more responsible for, and thus strengthen, their own accounting functions. From a central agency perspective, full implementation of new systems should improve the timeliness and efficient production of accounting information. This will result from much less manual intervention at the centre to produce consolidated information. In addition, detailed information will be handled by departments and agencies, and not by central agencies. As a result, the accounting function at the centre should have more time to devote to forward-looking analysis and interpretation.

Accrual accounting throughout the year

3.56 Maintaining accounts primarily on a cash basis of accounting throughout the year and adjusting them to modified accrual only at the end of the year has created significant problems. As stated previously, it is difficult to predict the actual financial results of a particular year, or to prepare a budget for a subsequent fiscal year, when the most current financial information has been prepared using a different basis of accounting.

3.57 The challenge for the government is to put in place a process that permits credible and therefore more useful reporting of financial results throughout the year, thereby facilitating timely preparation of financial statements during the year and at year end. Accordingly, the modernization of accounting systems includes provision for moving to accrual accounting throughout the year.

Strengthening accounting for tax revenues

3.58 The 1994 report *Review of the Forecasting Accuracy and Methods of the Department of Finance* recommended: "The federal government should make changes to the accounting for the tax revenues to mitigate year end adjustment issues." It goes on to state, "The accounting method used by the government for tax revenues introduces some unhelpful volatility, when viewed from the perspective of the fiscal forecasters." The Minister of Finance therefore announced in the 1995 and 1996 Budgets the government's intention to strengthen the accounting for and reporting of income tax revenues by moving to some form of accrual accounting.

3.59 Currently, income tax revenues and the deficit or surplus for a reporting period can easily be affected significantly by incidental factors such as computer malfunctions, work slowdowns or strikes just prior to the end of that period. For example, the Department of Finance provided the following explanation in the August 1996 issue of *The Fiscal Monitor* for a reduction in Goods and Services Tax (GST) revenues:

The year-over-year decline in GST collections was due to the timing of receipts, as certain collections due at month end were remitted in early September. Under GST legislation, some monthly remittances are due on the last day of the month. If that day falls on a weekend or holiday, the remittances are not due until the first business day of the next month. These remittance procedures should have no impact on the collections results for the year as a whole, as adjustments are made at year end to correct for timing differences.

3.60 This explanation would not have been necessary with some form of accrual of tax revenues, because the August GST remittances “due” to be paid in September would have been “accrued” and shown in August where they belong.

3.61 Strengthened accounting for tax revenues should therefore result in more credible financial information because reported tax revenue will not be affected by factors such as technology or labour problems. It should also result in more useful financial information on the basis of which the Minister of Finance can forecast fiscal results for the year.

Full accrual accounting for capital assets

3.62 In his 1995 and 1996 Budgets, the Minister of Finance announced the government’s intention to implement full accrual accounting for capital assets. With this change in accounting practice, the costs of acquiring capital property will be recorded as assets, and will be charged to expenditures in any one year only to the extent that the assets were used in that year. To illustrate, a \$100 million capital asset with a useful life of 10 years would be charged to operations at the rate of \$10 million per year over the next decade; under the government’s present accounting rules, the full \$100 million cost of the asset is included in expenditures of the year in which it is acquired.

3.63 In a proposed policy, the Treasury Board Secretariat has described the benefits of the initiative as being:

- better accounting for the “cost” of government. Charging the full cost of an asset in one year and nothing later in its useful life does not accurately reflect the real annual cost of operating government programs;
- better decision making. Due to the use of the deficit as the principal tool for fiscal management, approval of large capital projects may be influenced by their adverse effect on the current-year deficit, despite being cost-effective on a multi-year basis. For the same reason, departments consider capital leases as a method of acquiring assets, despite the higher overall costs of this approach; and
- better accountability for capital assets. When a capital asset is expensed (or written off) on acquisition, in future years it becomes a “free good”, and therefore future-year costs of using capital assets (amortization) tend to be of less consequence or concern.

3.64 The government faces an enormous challenge in implementing full accrual accounting for capital assets. In the Auditor General’s Observations on the Financial Statements of the Government of Canada for the years ending 31 March 1995 and 1996, five cautions were outlined for the government to consider:

- Full accrual accounting for capital assets should be implemented at the departmental level, not just at the summary level.
- The government’s appropriation process should be harmonized with full accrual accounting for capital assets.
- Stringent rules for depreciating and valuing capital assets should be developed and implemented to avoid manipulation of reported results.

- The potential adverse behavioural aspects of accrual accounting for capital assets (weakened resolve for fiscal restraint) should be considered carefully and avoided.
- Certain of the government's capital assets (infrastructure, heritage and works of art) may require special consideration.

3.65 The government has started to take appropriate action on four of the five cautions. With respect to the issue of harmonizing the government's appropriation process with full accrual accounting for capital assets, much work still needs to be done. Without first determining how the appropriation process will harmonize with, and thereby facilitate, this change in accounting, the government could jeopardize its ability to manage and control these expenditures and report on their costs. More simply put, it makes little sense to seek legislative authority on one basis and to manage on another basis.

A related challenge — the year 2000

3.66 With the year 2000 approaching, the government is facing yet another significant challenge and risk. Most computer systems and applications have limitations that can prevent them from functioning as intended beyond the year 1999. This risk exists not only for accounting systems but for all other applications in governments and, indeed, in organizations throughout the world. We have been informed that the Treasury Board Secretariat has projects under way to address this issue in departments and agencies. The Office of the Auditor General is also currently addressing this issue and will report on it later this year. At this time, it is sufficient to say that this systems challenge makes addressing the four challenges noted above more daunting.

What Lessons Did We Learn from Others?

3.67 Throughout the world, organizations are facing some, if not all, of the challenges that we have described above for the Government of Canada. Many organizations have implemented changes in their accounting functions to address those challenges.

3.68 As part of this study, we carried out interviews with private sector organizations, several provincial governments and certain national governments. While none of the organizations we studied are strictly comparable, either in size or complexity, with the Government of Canada, their collective experience is nevertheless worth considering.

3.69 Exhibit 3.6 reflects a broad synthesis of our interviews. In many cases, interviewees discussed successful accounting functions in terms of overall authority, tools and people. In other words, the chances of success were enhanced when someone with overall authority was in charge, with the appropriate technological tools and with well-trained professional people at his/her disposal.

Exhibit 3.6

Overall Authority, Tools and People: Factors in Successful Accounting Functions

OVERALL AUTHORITY

In the private sector, there is a strong central accounting function residing in one place with one senior official in charge. Boards of directors, chief executives and management committees rely on this official to inform and advise them objectively on the financial consequences of the policies and programs advocated by those with operational responsibilities. In the public sector, one senior official is also clearly responsible for the accounting function, although responsibility for preparing the budget normally resides with another senior official.

TOOLS

Consolidation tools are used with little manual intervention, allowing audited annual financial information to be released less than three months after year end. These consolidation tools are also used for quarterly and monthly financial information using the same basis of accounting. The quarterly financial statements may be subject to some limited “review” by independent auditors and are released within one month of the quarter end. (A review differs from an “audit” in that its scope is narrower and the assurance provided is lower — the auditor simply tries to assess whether the information is “plausible”, or worthy of belief.) Monthly financial information is generated only for management review, not normally for public release.

PEOPLE

People throughout the organization recognize the value of the accounting function and the benefits of accrual accounting.

Professionally qualified accountants are employed at the centre and their primary role is to perform analysis and interpretation of accounting information. Significant training is given to enable them to use accounting information in this way and to offer sound advice for decision making. Other users of accounting information also obtain guidance in order to understand and use the information wisely.

Professionally qualified accountants carry out the accounting functions in the organizational units (subsidiaries or departments). The senior official in charge of accounting provides strong functional leadership to these units even though they may report directly to their organizational heads.

Significant training is required of the accounting staff in organizational units, particularly when a major shift in accounting policies (such as accrual accounting) is implemented. The training is normally led by the central accounting function.

Enhancing the Government’s Chances of Success

3.70 We believe that implementation of the significant changes in accounting systems and accounting rules discussed in this chapter should do much to modernize and strengthen the government’s central accounting function. In making these changes, we would encourage the government to consider our observations and recommendations, which we believe should enhance the chances of success in this most important and far-reaching government initiative.

Analysis of government-wide financial information

3.71 As described earlier, the government needs timely and meaningful analysis and sound advice from the accounting function. A good accounting function can often highlight problems throughout the year that need to be corrected before they become critical. In addition, it can provide invaluable support in preparing the Budget for the next fiscal year and in updating the forecast of financial results for the current fiscal year. This exercise, normally carried out in the late fall and early winter, is without doubt one of the most important events in the government’s calendar. In our view, budget forecasts of deficits and debt should be based on credible information and analysis from the accounting function.

3.72 **The government should strengthen its capability to analyze and interpret government-wide financial information on an ongoing basis throughout the year.**

Strategy for published financial reports

3.73 The government meets various legislative and international requirements by publishing its three main financial reports: the annual *Public Accounts of Canada*, the *Annual Financial Report of the Government of Canada* and *The Fiscal Monitor*. Including the opinion of the Auditor General on the summary financial statements in the annual reports enhances the reports’ credibility. Most national governments do not publish overall financial

statements together with an independent opinion from their auditors. Clearly, we believe that Canada is at the forefront internationally in this type of reporting; however, improvements can still be made.

3.74 For example, many of the organizations included in our study do not publish monthly financial statements. The norm is to publish quarterly financial statements within either a mandated time frame or within a time frame expected by users of the financial statements. Those statements are prepared in accordance with generally accepted accounting principles, include information on assets and liabilities, revenues and expenses and cash flows, and are often available within a few weeks of the quarter end. In addition, the quarterly financial statements are sometimes subject to some limited review by the organizations' independent auditors.

3.75 *The Fiscal Monitor* includes information only on revenues and expenditures and on cash and debt balances, not on all assets and liabilities. This monthly information is often difficult to interpret, because revenues and expenditures are not evenly distributed throughout the fiscal year. Resultant monthly deficits and surpluses, particularly in the first several months of the fiscal year, are therefore not indicative of the eventual results for the year. Further, there is currently no means to compare interim financial results with the Budget, as it is not broken down into interim periods.

3.76 Finally, annual financial information is not published on a timely basis.

3.77 **To enhance usefulness and credibility, the government should review its strategy for publishing financial statements during the fiscal year.**

3.78 One option the government could consider would be to discontinue the monthly financial statements, to be replaced with a few simple and key monthly measures of financial results, such as cash balances and debt levels. Only quarterly financial statements would be published. The statements would include assets and liabilities, and revenues and expenditures together with some method of comparing the quarterly results with the Budget. In addition, the government could consider having these financial statements subject to some form of review by the Auditor General.

3.79 **To improve timeliness, the financial statements during the year should be published within no more than one month of the period end. Upon full implementation of the Financial Information Strategy, the audited financial statements included in the *Annual Financial Report of the Government of Canada* should be published within no more than three months of the fiscal year end, with the *Public Accounts of Canada* tabled in Parliament as soon as possible thereafter. Annual and monthly reporting time frames should be made public in advance so that users can know when to expect financial information.**

3.80 In summary, action on these recommendations coupled with the successful implementation of the Financial Information Strategy should ensure that all of the characteristics of a well-performing accounting function are present. However, to ensure the successful implementation of the Strategy, we believe the government should also consider the following observations and recommendations.

Central guidance to the accounting function in departments and agencies

3.81 As noted previously, we have restricted our review of the government's accounting function to the central agencies. However, we are aware that in government departments and agencies, accrual accounting is generally not used. Further, the value of accrual accounting may not be readily apparent to staff in departments and agencies if resources granted by Parliament are not based on accrual accounting.

3.82 Under the Financial Information Strategy, accrual accounting will be implemented by departments and agencies. Consolidation of that information into the government's summary accounting systems will be only as successful as the credibility of the information submitted by those subsidiary organizations.

3.83 Most governments and private sector companies that we contacted during this study emphasized that employees throughout an organization must recognize the value of the accounting reforms. In addition, they indicated that significant training is required, not only to underline to employees the value of the reforms but also to implement and operate them.

3.84 **The government should assess the capability of accounting groups within departments and agencies to implement new systems and accrual accounting, and should provide strong functional guidance to them, particularly during the period of transition.**

3.85 Chapter 2 of this Report describes work being conducted by our Office, in conjunction with the Treasury Board Secretariat, to develop a Financial Management Capability Model — a tool that, once completed, could be used by our Office and by departments and agencies to assess their financial management capability. The accounting function is part of financial management and this model may be helpful in assessing its capability. Training in the value and techniques of accrual accounting in departments and agencies needs to be developed as quickly as possible so that people throughout the entire government will be ready for its implementation.

Amalgamation of the central accounting function

3.86 We received a clear message from officials we interviewed, particularly in the private sector, that one individual with overall authority must head up the accounting function. In the other public sector organizations we visited, we found the accounting function to be the responsibility of one senior official, while responsibility for preparing the budget normally resided with a senior official in the finance ministry.

3.87 We also found that the function's primary resources are people and adequate technological tools. Particularly when the accounting function is undergoing fundamental change, such as we have described for the Government of Canada, these concepts of overall authority, tools and people, described in Exhibit 3.6, are of paramount importance.

3.88 In the Government of Canada, no one individual has been assigned overall authority for the accounting function. At the political level, the Minister of Finance is clearly responsible for the fiscal results reported by the accounting function. However, as noted previously, very few people reporting to the Deputy Minister of Finance are involved in that function.

3.89 Under the *Financial Administration Act*, the Minister of Finance and the President of the Treasury Board are jointly responsible for certain elements of the accounting function. That Act also provides the Treasury Board with authority to establish an officer with the rank and powers of a deputy head of a department and the title of the Comptroller General of Canada. Until 1993, there was a Comptroller General of Canada who, together with the Secretary of the Treasury Board, held deputy head status and reported to the President of the Treasury Board. Since that time, however, the two functions have been combined under one position. Again, very few people in the Treasury Board Secretariat are involved in the accounting function.

3.90 Finally, the Act assigns the bulk of accounting activities at the central agency level to the Deputy Receiver General for Canada (who is also the Deputy Minister of Public Works and Government Services Canada).

3.91 It is evident that below the Minister of Finance no individual has been assigned overall authority for the Government of Canada's accounting function at the centre. Further, the activities involved in the accounting function in the central agencies are spread out among three departments, each reporting to a different deputy head. One can therefore imagine that, on occasion, three different deputy heads will have three different sets of priorities, views or interests in that portion of the accounting function that is vested in their areas of responsibility. This situation could adversely affect many of the characteristics of a good accounting function that we described earlier in this chapter.

3.92 We have brought this fragmentation of the central accounting function to Parliament's attention in the past. In our 1976 Report, we recommended that the responsibility for maintaining the accounting records of Canada be amalgamated in the Treasury Board Secretariat under the Comptroller General of Canada. We also pointed out that this individual would have direct responsibility and accountability for all financial information systems designed for the use of the government, and the government could look to this individual for the integrity and adequacy of the financial information that it receives.

3.93 In 1987, upon the resignation of the Comptroller General, we wrote to the Clerk of the Privy Council and Secretary to the Cabinet emphasizing the need for an individual with overall authority, including the need for amalgamation of the accounting function under that person. We argued that this individual could be very useful in a lead role to make sure that ministers are not misled, by encouraging and supporting financial officers in departments and agencies to understand the importance of complete, accurate and timely information. Our view was that financial and economic information for ministers could be challenged by this individual to ensure that standards for completeness, accuracy and reliability are met.

3.94 The purpose of this study was not to consider all of the elements of comptrollership discussed in these previous reports. We also acknowledge that our recommendations were made under different circumstances. However, our views on the government's central accounting function as one element of comptrollership have not changed, particularly in today's circumstance of the significant changes under way to accounting policies and systems.

3.95 **It continues to be our view that the government should amalgamate its central accounting function. The newly amalgamated function should be led by an individual with overall authority to address the significant challenges posed by the accounting changes now under way and address the other recommendations in this chapter. The individual should have appropriate resources and be clearly accountable and responsible for addressing these challenges in a timely manner.**

3.96 The decision on how and where to amalgamate the central accounting function is clearly the government's and will involve some cost, some operational disruption and, in all likelihood, legislative amendment. Nevertheless, the significant challenges faced by the function make it imperative, in our view, to amalgamate and strengthen the function as discussed and recommended in this chapter.

Conclusion

3.97 The objectives of this chapter were to inform members of Parliament about the importance and quality of the government's accounting function and the significant challenges it faces, and to identify concerns and make recommendations to improve the function.

3.98 We hope that our chapter will also help other readers better understand the function and its importance. And we hope that our observations and recommendations will help the government implement its Financial Information Strategy successfully, and maintain its leadership role in financial reporting within Canada and abroad.

***Government's comments:** The government acknowledges the findings and recommendations of the Auditor General. However, in view of the profound changes the government is undergoing in how it operates, the resources available to it, and the challenges, risks and opportunities it faces, the Secretariat has recently established an Independent Review Panel on Comptrollership that will review and make recommendations on the comptrollership function within the government. The government will consider the recommendations of this chapter in conjunction with recommendations emanating from the Independent Review Panel.*

About the Study

Objectives

Our objectives were:

- to inform members of Parliament about the importance and quality of the government's accounting function and the significant challenges it faces; and
- to identify concerns and make recommendations to improve the function.

Scope and Approach

This study is based on the following key activities:

Reviewing and documenting —

- links to previous audits performed by the Office of the Auditor General and annual Observations and Opinions included in the Public Accounts of Canada
- links to the Financial Information Strategy

Reviewing responsibilities for the government's accounting function —

- Treasury Board Secretariat — Financial and Contract Management Sector, Government Accounting Policy Division
- Finance — Economic and Fiscal Policy Branch, Fiscal Policy Division
- Receiver General function in Public Works and Government Services Canada — Government Operational Service Branch, Central Accounting and Reporting Sector
- Government departments, agencies and Crown corporations (only at a level required to understand their links to the responsibilities noted above)

Understanding and documenting the framework for the accounting function in government —

- description of the accounting process and major outputs
- roles and responsibilities of other related entities including: Office of the Auditor General, Parliament, Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants

The work performed included researching existing literature, and conducting interviews of officials in the following organizations:

- Department of Finance
- Treasury Board Secretariat
- Receiver General function in Public Works and Government Services Canada
- private sector companies
- other national governments
- provincial governments

In conducting interviews with officials from large private sector organizations, other national governments and provincial governments, we sought to learn how their organizations conduct their accounting and financial reporting activities, how they deal with challenges similar to those facing the Government of Canada, and what lessons they learned while addressing those challenges.

Study Team

Martine Carrier
Cheryl Munro
Martin Ruben

For information, please contact John Hodgins, the responsible auditor.

Chapter 4

Control of the Transboundary Movement of Hazardous Waste

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Control of the Transboundary Movement of Hazardous Waste

Commissioner of the Environment and Sustainable Development: Brian Emmett
Responsible Auditors: Dan Rubenstein or Wayne Cluskey

Main Points

4.1 The primary objective of this audit was to determine whether Environment Canada, in co-ordination with other federal departments and the provinces, has established an effective and comprehensive regime to control the transboundary movement of hazardous waste consistent with Canada's international commitments.

4.2 Environment Canada has made a good start in establishing an effective and comprehensive regime to control transboundary movements of hazardous waste, but there are still some significant deficiencies. For example, Environment Canada has yet to establish the required capacity for proactive prevention of illegal shipments of hazardous waste. At the border, there is limited enforcement action directed to detecting illegal traffic in hazardous waste.

4.3 Canada has an obligation, under international agreements it has signed, to control the exports and imports of hazardous wastes. Revenue Canada Customs Border Services does have an infrastructure to monitor imports on an ongoing basis, but it is not operationally set up to physically control individual export shipments.

4.4 There are real monetary incentives for illegal traffic. For example, the cost of processing a legal truckload of hazardous waste can range from \$300 to \$1,200 a tonne.

4.5 There is limited chance of detecting illegal traffic in hazardous waste at the border; inspection and effective testing of samples of potentially illegal imports and exports are limited. Moreover, there is an even lower chance of detecting illegal shipments of hazardous wastes at marine ports or railyards.

4.6 In an area such as controlling the transboundary movement of hazardous waste, the chain is only as strong as the weakest link. In our opinion, as a result of the significant gaps in the areas of prevention, detection and enforcement and the limited facilities to physically control exports of hazardous waste at the border, Canada is not in a position to know the extent to which it is living up to its international obligations with regard to preventing illegal traffic at the border.

Introduction

Canada is a significant producer of hazardous waste

4.7 Hazardous waste is a cost of doing business. At the heart of much of the industrialized world's present standard of living is a vast array of chemical-based consumer products that are considered essential. In the manufacturing of thousands of these products, hazardous wastes are produced despite the use of on-site reduction and recycling programs. These wastes pose a formidable challenge: how to recycle and dispose of them safely with minimal risk to the environment and human health. There is a well-established waste management industry in Canada, which is making a significant contribution to the Canadian economy. The members of this industry make considerable efforts to comply with the rules and regulations pertaining to the transboundary movement of hazardous waste.

4.8 Environment Canada estimates that 5.9 million tonnes of hazardous waste is generated in Canada each year and 3.2 million tonnes is sent to off-site specialized treatment, recycling and disposal facilities. In 1995, Canada imported 383,134 tonnes of hazardous waste, more than 70 percent of which was destined for recycling. That same year, Canada also exported 225,989 tonnes of hazardous waste, more than 55 percent of it destined for recycling. The provinces of Quebec, Ontario and British Columbia export and import the highest volumes of hazardous waste.

4.9 Risks to health, safety and the environment. Typical industrial hazardous wastes include heavy metal solutions and residuals; sludges and inorganic residuals; solvents and inorganic solutions; clean-up residuals; oils and greases; paint and organic residuals; and pesticides and herbicides wastes.

4.10 Improper disposal of hazardous waste could put at risk the quality of Canada's environment and ultimately the health of Canadians, and also generate attendant clean-up costs in the future. There can be negative environmental and health effects in a receiving country, if hazardous wastes are improperly treated. Shipping a drum of hazardous waste for incineration may seem costly at \$300 but, for example, one litre of contaminated gasoline is sufficient to render a million litres of water unfit for human consumption. Moreover, through air, water or the food chain the effects of mishandled wastes may return to Canada.

Global recognition of the need to control transboundary movements

4.11 Hazardous waste is an international issue. Hazardous waste is like a gas that flows into the areas of least pressure. It will continue to leak out of a jurisdiction with a strict regulatory structure if it can leak into a jurisdiction with weaker regulations. For that reason, worldwide concern about the transboundary movement and disposal of hazardous waste was heightened in the late 1970s and early 1980s. The major concern was about waste being exported from industrialized nations to developing countries for cheap disposal at inadequately prepared sites. In the 1980s the international community began to develop global agreements with three broad objectives:

- establish controls on the international transboundary movements of hazardous waste (the focus of this audit);
- encourage minimization of waste; and
- encourage environmentally sound management of hazardous waste.

Canada's obligations under international agreements

4.12 The Government of Canada has indicated that it believes the uncontrolled export and import of hazardous waste would be a problem for human health and the environment. Three international agreements establish Canada's main international obligations for controlling the transboundary movements of hazardous waste.

4.13 The Canada–U.S.A. Agreement on the Transboundary Movement of Hazardous Waste. The United States is Canada's largest partner in the export and import of hazardous waste. As a result, in 1986 Canada entered into a bilateral agreement with the United States to regulate transboundary movement between the two countries. Some of the details of this agreement are set out in Exhibit 4.1. It was a logical step for Canada to extend the experience with this transboundary framework and its experience within the OECD to the broader international community.

Exhibit 4.1

Canada's Key International Obligations Canada/U.S. Bilateral and OECD Decision

Agreement	Excerpts: Specific Obligations to Control Transboundary Movements of Hazardous Waste
Canada/U.S. Bilateral Agreement on the Transboundary Movement of Hazardous Wastes	<ul style="list-style-type: none"> • Exporting country must notify the importing country of proposed shipments of hazardous waste. • Importing country has 30 days to consent, consent conditionally or object. No response within 30 days is assumed to mean consent. • Waste shipments require a manifest. • Exporter must provide for readmission of exports if returned by the country of import. • Parties are responsible for ensuring that their domestic laws and regulations are enforced regarding transportation, storage, treatment, and disposal of transboundary shipments of hazardous waste.
<p>Decisions of the Council Concerning the Control of Transfrontier Movements of Wastes Destined for Recovery Operations C(83) 180(Final); C(86) 64(Final); C(88) 90(Final); 178(Final); and C(92)39</p> <p>Organization for Economic Co-operation and Development (OECD)</p>	<ul style="list-style-type: none"> • Facility for recovery operations must be authorized by the applicable domestic law. • Transfrontier movements must adhere to applicable international transport agreements. • Transit through a non-member country shall be subject to applicable international and national laws and regulations. • Three-tiered system (green, amber, red) was developed to apply to controls of wastes destined for recovery (i.e. recyclables): <ul style="list-style-type: none"> - green tier: normal commercial controls only; non-hazardous waste. - amber tier: valid written contract, starting with notifier and terminating at the recovery facility, including financial guarantees for alternative recycling or disposal and required notification for re-export; tacit consent; hazardous waste that poses a moderate risk.

- red tier: same controls as amber list except that written consent prior to movement must be received from the importing and any transit countries; hazardous waste that poses a high risk.

4.14 Basel Convention. The Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal was ratified by Canada on 28 August 1992. The Basel Convention is the only global agreement specifically targeting movements of hazardous waste. The controls established by the Basel Convention attempted to:

- prevent the transfer of environmental risks to jurisdictions that do not have the capacity to manage them in an environmentally sound manner; and
- allow the export of hazardous waste when it can be ascertained that it will be managed in an environmentally sound manner.

4.15 The control regime established by the Basel Convention met these two goals by adopting a “prior informed consent” notification procedure. Exhibit 4.2 describes in more detail some of the key obligations related to prior informed consent. Since the Basel Convention came into force in May 1992, the parties to the Convention have conducted three Conferences of the Parties: in December 1992, in March 1994, and in September 1995. The Convention as such is a relatively new agreement, and the parties are in the process of developing new tools to meet the objectives of the Convention.

Exhibit 4.2

Canada’s Key International Obligations - Basel Convention

Agreement	Excerpts: Specific Obligations to Control Transboundary Movements of Hazardous Waste
Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal	<ul style="list-style-type: none"> • Parties are prohibited from exporting hazardous waste to: Antarctic region; non-parties to the Convention (except where an Article 11 agreement applies); states that have prohibited all imports of hazardous waste; states that the exporting country believes will not manage the waste in an environmentally sound manner; and states that do not consent to receive the waste. • The exporting country is responsible for ensuring that its exported hazardous wastes are managed in an environmentally sound manner. • The exporting country must notify the importing country of proposed shipments of hazardous waste; prior informed consent (PIC) procedure. • The shipment cannot be sent unless the importing country consents in writing. • Waste shipments require a manifest. • There must be a contract between the exporter and importer. • Each shipment must be packaged, labelled, and transported in conformity with generally accepted and recognized international rules and standards.

- The exporter must provide for readmission of exports if returned by the country of import.
- Both the exporter and the exporting state must be informed of receipt and ultimate disposal of the waste.
- Each party must introduce national legislation to prevent and punish illegal traffic of hazardous waste.
- Each Party shall take appropriate legal, administrative and other measures to implement and enforce the provisions of the Convention, including measures to prevent and punish conduct in contravention of the Convention.
- Parties may enter into bilateral, multilateral or regional agreements or arrangements regarding transboundary movements of hazardous wastes or other wastes, provided that these agreements do not derogate from the environmentally sound management of hazardous wastes as required by the Convention.

4.16 In September 1995, at a meeting of the Basel Convention parties, a decision was made to amend the Convention to immediately prohibit the export of hazardous waste for disposal from developed to developing countries, and to phase out by the end of 1997 and prohibit as of that date the export of hazardous waste for recycling from developed to developing countries. Although Canada did not oppose this ban, it has stated that it will not consider the ratification of the amendment until the work on the clarification of the definition of hazardous waste is completed.

4.17 The proposed Basel Convention ban has also renewed discussion about the relationship between Canada's obligations under the Basel Convention and its trade obligations, an issue that has been around since the beginning of the Basel Convention. The Basel Convention is one of the principal multilateral environmental agreements (MEAs) thought to raise questions of consistency with certain rules under the General Agreement on Trade and Tariffs (GATT)/World Trade Organization (WTO). The relationship between trade measures in multilateral environmental agreements and trade rules of the WTO has been taken up by the WTO Trade and Environment Committee and is currently under discussion.

4.18 OECD decision. A decision on 30 March 1992 by the OECD Council applied to the transboundary movement of waste destined for recovery operations in OECD countries. It established a three-tier classification and control system based on risk criteria, as illustrated in Exhibit 4.1.

4.19 These major international environmental agreements to which Canada is a signatory confer upon Canada the obligation to control the export and import of hazardous waste for recycling and disposal.

4.20 Domestic regulatory regime. Hazardous waste is regulated in Canada in a variety of ways. The provinces are responsible for regulating the generation, treatment and disposal of all waste within their borders. The interprovincial and international movements of hazardous waste are regulated at the federal level, whereas the intraprovincial movements of hazardous waste are regulated at the provincial level, based on the federal Transportation of Dangerous Goods Regulations. Each of the provinces and territories also regulates the management of waste of all kinds, including hazardous waste.

4.21 International controls. The federal government regulates the import and export of hazardous waste. In November 1992 it introduced the Export and Import of Hazardous Wastes Regulations (EIHWR Regulations) promulgated under the *Canadian Environmental Protection Act*. These regulations control the export and import of

hazardous waste in accordance with the Basel Convention, the OECD Council Decision on transboundary movements of waste destined for recovery operations and the Canada–U.S.A. Agreement. Canada has chosen to strengthen its regulatory regime by including in these regulations some features not explicitly specified under these international agreements, such as insurance requirements, notification of imports and collection of manifest documents at the border.

4.22 Canada’s international obligations have played a large role in shaping its legislative and policy regime for controlling the transboundary movement of hazardous waste. The effective implementation of Canada’s major international agreements requires, in our opinion, a well–crafted, easily comprehensible and enforceable regulatory regime; effective promotion of compliance; effective enforcement practices; and strong partnerships between agencies and countries.

Focus of this audit

4.23 As described in greater detail at the end of this chapter in **About the Audit**, this was part of a series of audits dealing with the issue of waste minimization and what the federal government is doing to manage the environmental risks posed by hazardous waste.

4.24 The focus of this audit was on the main element in the federal regulatory regime for the transboundary movement of hazardous waste, the Export and Import of Hazardous Wastes Regulations (EIHWR). The audit excluded the domestic regulatory regime for the control of hazardous waste, as well as all areas of provincial jurisdiction over the management of waste of all kinds, including hazardous waste. Future audits are planned to deal with compliance promotion and enforcement of other regulations under federal environmental legislation such as the *Canadian Environmental Protection Act* and the *Fisheries Act*.

4.25 The primary objective of this audit was to determine whether Environment Canada, in co–ordination with other federal departments and the provinces, has established an effective and comprehensive regime to control the transboundary movement of hazardous waste — one that is consistent with Canada’s international environmental commitments and obligations to ensure environmentally sound and efficient management of such wastes.

Observations and Recommendations

Best Practices for Promoting Compliance and for Effective Enforcement

4.26 As part of our audit work, we reviewed best practices for controlling the transboundary movement of hazardous waste. We conducted extensive interviews in both Canada and the United States, where we researched joint force operations. The model that emerged from all of our research and interviews is illustrated in Exhibit 4.3 and described in this initial set of observations. We used this model framework as a template against which to report our observations. This framework is intended to implement the prior informed consent procedure and to track shipments of hazardous waste, as called for in international agreements to which Canada is a signatory, to both promote compliance and deter illegal shipments of hazardous waste. A common theme in all our interviews on best practices was the need for a framework that could deal with illegal traffic.

Exhibit 4.3

(This exhibit is not available, see the Report)

The challenge of controlling illegal traffic

4.27 The terms “enforcement” and “compliance” are used many times throughout this chapter. It is therefore useful to make their meanings clear. Compliance means the state of conformity with the law. Compliance is secured through two types of activity: promotion and enforcement. Measures to promote compliance include communication and publication of information, consultation with parties affected by an Act, technical assistance and technology development. Enforcement activities include:

- inspection and monitoring to verify compliance;
- investigations of violations;
- measures to compel compliance without resorting to formal court action, such as directions by inspectors, ticketing, and ministerial orders; and
- measures to compel compliance through court action, such as injunctions, prosecution, court orders upon conviction, and civil suit for recovery of costs.

4.28 For the purpose of this audit we have distinguished between illegal traffic and administrative non-compliance, which is also illegal. *Illegal traffic* essentially is a serious environmental crime capable of producing dangerous impacts, including threats to human health. Administrative *non-compliance* can occur through error, ignorance, and technical or relatively minor administrative breaches.

4.29 There can be a criminal intent to illegally dispose of hazardous wastes, in Canada, the United States or abroad, in order to avoid paying the disposal fees and to realize significant profits. The Basel Convention obliges each party to take appropriate legal, administrative and other measures to implement and enforce the provisions of the Convention, including measures to prevent and punish conduct that contravenes the Convention. The Basel Convention defines illegal traffic as any transboundary movement of hazardous wastes or others:

- without notification to all states concerned;
- without consent of all states concerned;
- with consent obtained from states through falsification, misrepresentation or fraud;
- that does not conform in a material way with the documents; or
- that results in a deliberate disposal (for example, dumping) of hazardous wastes or other wastes in contravention of the Basel Convention and of general principles of international laws.

4.30 **Illegal traffic: deliberate false statements.** Shippers who deliberately make false statements are breaking the law. There can be a deliberate misrepresentation of what the load actually contains (that is, the paperwork does not match the content of the shipment) or a deliberate misdirection (a false statement of how the material will be handled or where it will go for final disposal). Misrepresentation could occur, for example, when the shipper’s manifest indicates construction material but the content is metal scrap with a high lead content, which is considered a hazardous waste. Misdirection could occur when a shipper states that a load is going to a designated treatment facility but the load is ultimately dumped by the side of the road, or shipped through Canada or the United States to an unspecified third-world country. Environment Canada cannot confirm the final destination unless it receives the required documentation. Lack of receipt of this could indicate misdirection.

4.31 There are also shippers who operate entirely outside the regulations and do not complete any of the required paperwork.

4.32 We reviewed three major studies addressing the problem of illegal traffic in hazardous waste. One report in particular revealed that Customs Border Services appreciates the potential gravity of the problem. In a 1994 report prepared by the Enforcement Directorate at Revenue Canada's Intelligence Services Division, the authors concluded that:

- “ • a large amount of illegal hazardous waste is moving across the Canadian border;
- illicit hazardous waste is difficult to detect at the border;
 - there is a proven involvement of organized crime in the waste management and disposal industry in the United States; and
 - illicit transborder movements of hazardous waste will increase.”

4.33 Little chance of getting caught. We observed that there are real incentives for illegal traffic. There is considerable money to be made, a low chance of detection, and an even lower chance of receiving administrative, civil or criminal sanctions. The disposal of a legal truckload of hazardous waste, typically 22 metric tonnes, may easily cost ten thousand dollars. There are also costs for liability insurance and brokerage, and an approximately 35– to 40–day waiting period for completion of the required paperwork. Illegal shipments involve no paperwork and no recycling or disposal costs, whether disposed of in Canada or abroad. There is a small chance of getting caught given the volume of traffic at the border and the variety of substances that are potentially hazardous waste. Once violators are caught, infractions of the Export and Import of Hazardous Wastes Regulations have not resulted in large penalties.

A model framework for compliance and enforcement

4.34 Compliance promotion and permitting. As illustrated in Exhibit 4.3, conceptually there are four key domestic components of a model framework for enforcement and compliance. *Compliance promotion* would involve disseminating information to clients such as shippers or producers of hazardous waste, as well as responding to inquiries from the general public and clients. *Permitting* would primarily involve reviewing export/import applications, issuing letters of consent and reviewing final documents and completion of movements. Compliance promotion and permitting would be the responsibility of Environment Canada.

4.35 Detecting illegal traffic at the border. The third component would be *detecting illegal traffic at the border*. This would be done by Revenue Canada's Customs Border Services and regional enforcement officials of Environment Canada. As illustrated in Exhibit 4.3, Customs officers would be the first line of defence. Ideally, Customs Border Services would exercise ongoing vigilance in looking for illegal shipments of hazardous waste. If they suspected such a shipment, they would contact Environment Canada officials who would have the requisite expertise to inspect the shipment safely and to take samples as appropriate. For this to be effective, Environment Canada as the lead agency would provide the training necessary to sensitize Customs officers to the issues surrounding hazardous waste. Furthermore, Environment Canada would provide Customs officers with a list of specific items to look for, and with intelligence information to know what shipments of hazardous waste to stop and whom to contact.

4.36 Proactive prevention and detection. Conceptually, an important component of this regime would be *proactive prevention and detection*. This would increase the effectiveness of the overall enforcement system, both through increased interceptions and through an increase in the perceived risk of detection at the border. The goal of such an approach would be to identify high-risk situations where specific enforcement actions could be targeted.

This would generally be done by joint force operations and would involve the Transboundary Movement Division and the enforcement divisions of Environment Canada, Customs Border Services, the RCMP and the provinces, as well as U.S. counterparts. Effective enforcement would require that Environment Canada interact with other agencies, developing and co-ordinating its enforcement efforts with a cognizance of the work of various domestic and international organizations focussing on hazardous waste traffic. This would involve a continuous sharing of information.

4.37 Prosecutions. Although compliance is the ultimate goal, enforcement and prosecution comprise one of the established means to achieve this end.

4.38 International enforcement. The last component, international enforcement, would involve liaison activities between Canadian enforcers and regulators and other organizations in the international enforcement community.

4.39 The balance of our observations compare actual practices with the ideal federal regulatory framework previously described and illustrated in Exhibit 4.3.

Environment Canada Is Putting Effort into Compliance Promotion

4.40 Compliance promotion. The Export and Import of Hazardous Wastes Regulations were introduced in November 1992. In the first two years of their implementation, the Department developed and used various tools to educate the regulated community about the requirements of the Regulations. Following that education campaign, and based on the number of notifications and manifests received, the Department undertook to completely redesign its computerized tracking system. Environment Canada has informed us that now that the proper infrastructure is in place, the Department will be able to use this information to strengthen its enforcement program with respect to hazardous waste.

4.41 The Transboundary Movement Division of Environment Canada produced several users' guides, newsletters and other training publications. The Division recently completed an assessment of clients' satisfaction, which produced positive results. Based on our review of the documents provided to us and on our interviews at head office, in the regions and with selected shippers, we concluded that compliance promotion had been done well during the introduction of the regulations. Ongoing efforts to promote compliance include developing, publishing and distributing guidance material to the regulated industry and responding daily to inquiries on how to comply with the regulations.

Concerns about compliance rates

4.42 Permitting. As described in Exhibit 4.3, permitting would involve managing the paperwork and approvals required by the Export and Import of Hazardous Wastes Regulations.

4.43 The Transboundary Movement Division of Environment Canada processes all of the information submitted by exporters, importers and transporters of hazardous waste, as required under the EIHW Regulations. Central to permitting are the systems described in the special insert on page 4-16, "The Notification and Manifest Systems". Annually, the Division processes approximately 5,500 notices for imports, exports and transits of hazardous waste and as well as some 75,000 manifest copies to track approximately 25,000 shipments. This process includes reviewing the accuracy of submitted information for consistency with regulatory requirements, operating the computerized notification and manifest tracking system and working in close co-operation with the appropriate authorities in the provinces and in other countries, in order to obtain the consent needed to ship hazardous wastes and hazardous recyclable materials.

4.44 We concluded that the mechanics of the process were in place and working, but we did have concerns when we reviewed the rates of compliance with some of the regulatory provisions. Our areas of concern were the relatively low rates of compliance with the manifest requirements and with the certificates of disposal/recycling, as reported in an internal compliance report covering the period from November 1992 to December 1994.

4.45 Low compliance rates. Areas of low compliance were noted for both exports and imports, particularly with the regulatory provisions for the manifests (28 percent compliance for exports; 53 percent for imports) and certificates of disposal/recycling (67 percent compliance for exports; 62 percent for imports). Manifesting requirements include the submission of various copies of the documents. In many cases, Environment Canada has received either the consignor or the consignee copy of the manifest, but not both. Also, the fact that manifest copies must be returned by persons from other countries makes some documents more difficult to obtain, especially from countries where the material is not regulated. As noted, compliance with the manifesting requirements is somewhat higher for imports than for exports. Exporters who ship small and infrequent quantities are less likely to be aware of and to comply with their obligations than are Canadian importers, who are mostly larger companies shipping larger volumes.

4.46 Significance of low compliance rates. The significance of low compliance rates is that Environment Canada cannot be sure that the hazardous wastes have reached their final destination or been properly disposed of or recycled. Some shipments could have been illegally shipped overseas to jurisdictions in developing countries that do not have the capacity to manage them in an environmentally sound manner.

4.47 The Transboundary Movement Division reported that recent efforts have been made for export manifests, and compliance rates increased in the period from July to November 1996. However, in the same period compliance rates for import manifests dropped significantly. In our opinion, fluctuations in compliance rates should be researched to determine their causes. The Division is aware of the low compliance rates, but reported that it may not currently have the necessary capacity to improve some of these compliance rates. In our opinion, the Division needs to further analyze the root causes of non-compliance, and its nature, in order to evaluate the extent to which the non-compliance may or may not be related to administrative requirements.

4.48 Environment Canada should find solutions to improve the rates of compliance with requirements for the manifests and certificates of disposal/recycling.

Environment Canada's response: Agree. Environment Canada continues to enhance the computerized manifest and notification tracking system, which will improve its ability to assess the level of compliance of hazardous waste from the time it leaves the shipping site until final disposal or recycling and to take appropriate action. Environment Canada will allocate adequate resources to improve the rates of compliance for the manifests and certificates of disposal/recycling.

THE NOTIFICATION AND MANIFEST SYSTEMS

All of the transboundary movements of hazardous waste are subject to the Export and Import of Hazardous Wastes Regulations, which require that a Notice of proposed export, import or transit be submitted to Environment Canada prior to shipment. This notification process allows the receiving country or province to review the hazardous waste in relation to its destination and to provide consent to Environment Canada before any shipment takes place. Each Notice is valid for up to a year and may represent a number of shipments over that period.

Once a Notice has been approved, each shipment must be accompanied by a Canadian Waste Manifest, which describes the hazardous waste contents of a vehicle or a vessel, along with a copy of the Notice and confirmation letter issued by Environment Canada. A copy of the Manifest is sent to Environment Canada by the "generator" of the waste at the time the shipment leaves a facility; a copy is to be dropped off at Customs when crossing the Canadian border. This copy is to be forwarded to Environment Canada. A third copy is to be sent to Environment Canada by the "receiver" of the hazardous waste. In addition, once the hazardous waste has been disposed of, or recycled, a Certificate of Disposal/Recycling is to be forwarded to Environment Canada confirming the completion of the operation.

Little Chance of Detecting Illegal Traffic

4.49 This section of our observations describes what is *not* happening, either at the border or inland, with regard to the detection, inspection, and ultimately the prosecution of illegal traffic in hazardous waste. (See Exhibit 4.3).

Limited detection of illegal imports at the border

4.50 Revenue Canada Customs Border Services is the first line of defence for all imports crossing the border into Canada. Revenue Canada Customs Border Services assists 18 other federal government departments in the administration of 86 related acts and regulations. Customs Border Services assists Environment Canada in the administration of the Export and Import of Hazardous Wastes Regulations by collecting and verifying documents, detaining shipments suspected of being in non-compliance with the regulations, and visual examination of the exterior of vehicles. A Memorandum of Understanding exists between Environment Canada and Revenue Canada that outlines the roles and responsibilities of each. Customs Border Services has issued a bulletin detailing the procedures that carriers and the Department are to follow in the transboundary movement of hazardous waste. According to the Memorandum, there is no obligation for Customs Border Services to conduct inspections. However, Customs officers are to identify shipments they suspect to be hazardous waste through a visual inspection of the safety markings, description and stenciling on transport units. The responsibility for inspections rests with Environment Canada.

4.51 We visited three regions that account for 99 percent of Canada's known imports of hazardous waste. We found that Customs officers verify the completeness of the paperwork provided by truckers when shipments of hazardous waste are imported into Canada. Given that the three border crossings identified in Exhibit 4.4 are some of Canada's busiest in known volumes of traffic of hazardous waste, we visited them to observe current practices. We recognize that there is also a risk of illegal exportation of hazardous waste at other border crossings, particularly in regions that do not have adequate treatment and recycling facilities.

4.52 Exhibit 4.4 demonstrates the limited level of inspections conducted by Environment Canada at the border. For example, in 1995-96 in the Quebec region there were 28 phone calls between Environment Canada and Customs officers at the border, and only five actual visits by Environment Canada to inspect a transboundary movement of hazardous waste at the border. During this period there were 299,963 tonnes of known legal shipments of hazardous waste (approximately 7,500 truckloads). In the same period in Ontario there were 24 phone calls and 15 border visits. The regional volume for Ontario was 245,856 tonnes of legal hazardous waste (approximately 6,147 truckloads). In the Pacific and Yukon region there were five calls and one border visit relative to known legal shipments of 33,742 tonnes of hazardous waste (approximately 844 truckloads). The Pacific Highway crossing is very busy, with an average of 1,350 commercial vehicles using the border crossing every day. We concluded that the effort by Environment Canada to detect illegal shipments of hazardous waste at the border is limited, given the volume of shipments of hazardous waste.

Exhibit 4.4

Limited Detection of Illegal Imports at the Border

REGION 1995-96	Quebec Region		Ontario Region		Pacific and Yukon Region	
	Lacolle	Total	Sarnia/Port Huron	Total	Pacific Highway	Total
Activity at the border:						
Phone Calls	14	28	6	24	3	5
Border Visits	2	5	9	15	1	1

Total	16	33	15	39	4	6
Samples Taken	0	0	5	12	0	0
Investigations	1	4	2	6	0	1
Warnings	0	0	0	1	0	0
Directives	0	0	0	0	0	0
REGIONAL VOLUME (tonnes)	299,963		245,856		33,742	
Equivalent # of Trucks	7,500		6,147		844	

Source: Environment Canada

The exhibit does not include transit referrals/reviews, facility and rail inspections.

4.53 In our view, more work is needed to determine the potential extent of illegal traffic in hazardous waste in Canada. Until this is done, it will be difficult to determine what level of enforcement effort is appropriate.

4.54 In May 1995, Customs Border Services implemented a Commercial Compliance Measurement Project. The mandate of this project is to measure the rate of non-compliance for all commercial vehicles at the highway border crossings. These compliance measurement activities are conducted at 12 major border crossings representing almost 80 percent of highway commercial traffic entering Canada across the country. Customs Border Services recognizes the need for better intelligence information to allow it to further develop and review its strategic approach to detecting illegal traffic in hazardous waste. It stated that Environment Canada must be instrumental in providing it with information on the scope of the issues and the potential impacts on the health and safety of Canadians and others around the world, as well as the potential damage to Canada's international reputation, in order for Customs Border Services to allocate to this issue an appropriate level of priority. To date, Customs Border Services has not been provided with this information by Environment Canada.

4.55 While the Commercial Compliance Measurement Project will not deal with exports of hazardous waste, it could be a good starting point for Environment Canada, as the lead department, to begin quantifying the extent of potentially illegal imports of hazardous waste into Canada.

4.56 **Environment Canada should work closely with Revenue Canada Customs Border Services, and other appropriate international partners, to quantify the extent of potential illegal traffic in hazardous waste into and out of Canada. This information should be used to determine an appropriate level of enforcement effort.**

(A joint response from both departments follows paragraph 4.68.)

4.57 Under the Memorandum of Understanding between Environment Canada and Revenue Canada, Customs inspectors are not required to inspect shipments suspected to be hazardous waste, due to the associated personal health and safety risks. If Customs inspectors did suspect shipments to be hazardous waste, they would detain the shipment and contact Environment Canada with the details. If the shipment needs to be examined, this is to be undertaken by Environment Canada in accordance with the terms of the Memorandum of Understanding. Accordingly, Customs inspectors need training sufficient to enable them to recognize a hazardous waste, and to identify industrial activities that generate waste and the parties who may be involved.

4.58 **The need for more training.** Environment Canada has developed briefing material to inform Customs officers about hazardous wastes regulations. When the EIHW Regulations were implemented in 1992, all Customs inspectors received training with respect to their duties under this regulation. In 1996, Environment Canada developed refresher briefing material to update Customs officers on their duties with respect to this program. To

date, this refresher training has been provided in the Pacific and Yukon and the Atlantic regions and also on two occasions at Canada Customs facilities in Rigaud. Despite these efforts, we believe that enhanced training in the detection of suspect shipments is needed for Customs Border Services employees. Even at crossings with known higher volumes of hazardous waste traffic, there has not been an enhanced training effort. We believe that practical training aids could make a significant difference in sensitizing Customs officers. For example, in the case of chlorofluorocarbons (CFCs), Environment Canada provided Customs officers with training and other information. We noted that a colour poster identifying typical types of containers of banned CFCs was posted at a major border crossing. This improved the ability of Customs officers to identify types of containers that could be used for illegal shipments of CFCs. Although we support these efforts to improve the identification skills of Customs officers, we recognize that identifying illegal hazardous waste shipments is inherently more complex than with other forms of contraband.

4.59 Environment Canada should provide Customs inspectors with training sufficient to enable them to recognize hazardous waste and to identify industrial activities that generate hazardous waste, and the parties who may be involved.

Environmental Canada's response: Agree. Environment Canada, in addition to the current training being provided to Customs officers, will enhance its training to help Customs inspectors in the recognition of hazardous waste and in the identification of targeted activities or parties that may be involved in the transboundary movement of hazardous waste.

4.60 Low number of inspections by Environment Canada at the border. The number of inspections by Environment Canada at the border (see Exhibit 4.4) reflects both inspections initiated by a call from Customs Border Services and those captured by a border "blitz". There is a general consensus in the enforcement community that blitzes have limited effectiveness for catching illegal traffic, largely because the element of surprise is lost after the first hour and truckers can move to other border crossings. The number of inspections undertaken by Environment Canada as shown in the exhibit includes both those that involved opening the truck and those where the inspector merely reviewed the paper manifests. In our opinion, given the volume of traffic, the number of inspections is low.

4.61 Under the current accountability structure at Environment Canada, each Regional Director of the Environmental Protection Service is responsible and accountable for all enforcement decisions made in the regions. The Office of Enforcement at Environment Canada in Ottawa has functional responsibility for both inspections and investigations. To assure the adoption of national policies and to assure national consistency and uniformity, the Office of Enforcement needs to be aware of the level of enforcement activity in the regions. Our audit revealed that the information provided to headquarters by the regions does not adequately capture the level of enforcement activity at the borders. Inspections are not broken down by location. The regional staff at Environment Canada are not in a position to report how responsive they have been to requests from Customs Border Services. For example, in one region they do not keep the records that would allow them to report that out of 28 telephone calls, a certain number led to border visits. In another region, telephone calls are not recorded at all.

4.62 Effective sampling and analysis are vital for successful prosecutions. In all three regions we visited, enforcement officials acknowledged the increasing importance of effective testing of samples from suspect shipments. They told us that it is now difficult to mount a successful criminal prosecution without a sample that respects both the exact testing protocols set out in the *Transportation of Dangerous Goods Act* Regulations and "the chain of custody" procedures that are essential for effective criminal prosecution. In one region with heavy volumes of hazardous waste traffic, Environment Canada officials do not sample and do not have testing facilities or a mobile laboratory available. In one case, involving a Canadian exporter, the case did not proceed because there was no sample of the illegal shipment, and hence no physical evidence that the illegal export took place. This case was further complicated by lack of familiarity with the Export and Import of Hazardous Wastes Regulations, and the associated international agreements. As stated by Environment officials in both Ontario and British Columbia, "Without effective sampling there may be insufficient evidence to prosecute a ... case [successfully]." Therefore, the

possibility of prosecution is not a significant deterrent. Exhibit 4.4 illustrates the low level of samples taken. In 1995-96 no samples were taken in two of the three regions we visited.

4.63 Environment Canada should develop and implement a management strategy for obtaining and analyzing samples of hazardous waste. At a minimum, this strategy should address the issues of training, safety, frequency of sampling, knowledge of sampling protocols, locations, equipment and access to testing facilities.

Environment Canada's response: Agree. Environment Canada will adjust its current national priority action plan for enforcing the Export and Import of Hazardous Wastes Regulations to include a management strategy to improve its ability to obtain and analyze samples of hazardous waste. It will take into account the issues of training, safety, frequency of sampling, knowledge of sampling protocols, locations, equipment and access to testing facilities.

Even lower chance of detection at ports or railyards

4.64 No targeted inspections of containers exported by ship. By law and regulations, an interim report must be provided to Customs Border Services by an exporter, the agent of the exporter or the carrier prior to export and the vessel's sailing. As well, any documents required by other government departments' legislation are required to be provided to Customs Border Services prior to export. Given the volume of containers exported by ship, and the costs of inspecting a container, there is a need for intelligence information to be used in targeting inspections. Customs officials at the marine ports of Montreal and Vancouver advised us that virtually no imports of containers are inspected for potentially illegal shipments of hazardous waste. There are no data on the potential illegal movements of hazardous waste from Canada's marine ports. Currently, Environment Canada has not provided Customs Border Services with intelligence information that would allow it to randomly select containers for visual inspection. Containers are not randomly examined because of the high costs associated with examination and the fact that these costs are absorbed by the shipper.

4.65 Limited examination of trains. Relatively few rail containers are examined, whether imports or exports. All cargo transported by train is normally identified on a manifest, which is provided to Customs Border Services at the first point of crossing. If Customs Border Services decides that an examination is required, it could be undertaken at the point of release, that is, at the inland rail sufferance warehouse. Customs Border Services would detain shipments of hazardous waste at a point of release, based on intelligence information from Environment Canada.

4.66 We noted that Environment Canada has data on the level of shipments of hazardous waste by rail, but this information is not forwarded to Customs Border Services. We were not provided with examples where intelligence information on specific train cargoes had been forwarded by Environment Canada to Customs Border Services. Customs officers and Environment Canada inspectors in the regional offices we visited had minimal knowledge of the volume of hazardous waste transported by train, legally or illegally.

4.67 Customs Border Services told us that it had recognized that there was a problem in determining the levels of non-compliance and contraband with respect to rail shipments. It told us that as a result, it is currently conducting a Rail Examination Program. It expects that this will provide additional statistical data that can be used to further assess the potential threat in containers and rail shipments.

4.68 Environment Canada should work closely with Revenue Canada Customs Border Services to quantify the extent of hazardous waste transported by ship and rail, and work to determine the extent of potentially illegal traffic. This information should be used to establish an appropriate level of detection effort.

Revenue Canada Customs Border Services and Environment Canada's joint response: Environment Canada and Revenue Canada are working together with international partners to determine the extent of potentially illegal

traffic shipped via all modes of transport. The current level of enforcement and detection effort will be reviewed to strategically target the different modes of transport relative to the identified risk. A senior management steering committee, comprising Environment Canada and Revenue Canada representatives, will be established immediately to ensure that the necessary actions to determine the level of enforcement and detection efforts are undertaken.

Constraints to Effective Enforcement

The importance of setting priorities

4.69 The Department administers the *Canadian Environmental Protection Act (CEPA)*, the *Canadian Wildlife Act (CWA)*, the *Migratory Birds Convention Act (MBCA)*, and the *Wild Animal and Plant Protection and Regulation of International and Interprovincial Trade Act (WAPPRIITA)*. Under an administrative agreement with the Department of Fisheries and Oceans, Environment Canada also has primary responsibility for the pollution provisions of the *Fisheries Act*. As well, Environment Canada will be accountable for the soon-to-be-proclaimed *Canadian Endangered Species Protection Act (CESPA)*. In all, there are more than 30 regulations administered by Environment Canada under these Acts. The bulk of them fall under *CEPA* and the *Fisheries Act*. There are approximately 20 Environment Canada offices across Canada that carry out enforcement functions. Approximately 125 Environment Canada enforcement staff operate out of five regions and at headquarters. Approximately 60 persons are investigators or inspectors in the field for the *Fisheries Act* and the *Canadian Environmental Protection Act*.

4.70 The limited availability of resources underscores the importance of setting enforcement priorities. During the past two years, the national priorities have been the enforcement of pulp and paper regulations, hazardous and banned substances and the smuggling of endangered species and their parts. As part of their management process, in 1995 the enforcement program managers prepared a national priority project plan that sets out a long-term commitment to strengthen the enforcement of the Export and Import of Hazardous Wastes Regulations. The plan recognizes the enforcement of these relatively new regulations as a priority. It also recognizes the fact that additional partnerships with key federal, provincial and international agencies are necessary not only to help build the basic and intelligence information and institutional infrastructure for these new regulations but also to support effective investigations and prosecutions.

Limited prosecutions

4.71 Enforcement results. Investigations typically result from information received by the Environment Canada program people and from tips that suggest the possibility of systemic or extensive non-compliance. Successful prosecutions include both cases where the accused violator pleads guilty and those that go to trial and are prosecuted successfully. As illustrated in Exhibit 4.5, there have been few charges laid and even fewer convictions. However, in the past year there has been an increase in the level of enforcement activity. Officials in one region indicated to us that while they had taken a proactive approach to prosecution, in their opinion the limited number of successful prosecutions is largely a result of the complexity of the applicable laws and regulations. In our view, there is a need for additional training so those involved in enforcing and prosecuting the regulations understand their complexity.

Exhibit 4.5

Enforcement Results

	Quebec Region		Ontario Region		Pacific and Yukon Region	
	1988-96	1995-96	1988-96	1995-96	1988-96	1995-96
Cases Prosecuted	3	3	6	5	0	0
Number of Cases Stayed/Withdrawn	0	0	0	0	0	0
Number of Cases Still Before Courts	2	2	5	5	0	0
Number of Guilty Pleas/Summary Convictions	1	1	1	0	0	0
Number of Cases of Trial Convictions	1	0	0	0	0	0

Source: Environment Canada

4.72 Compliance with the regulations is the ultimate goal; successful prosecutions are an integral part of an effective deterrence strategy. We concluded that the incentives for illegal traffic in hazardous waste outweigh the present deterrents.

Definitional problems hamper enforcement effort

4.73 **The need for clear, understandable laws.** A fundamental requirement for effective enforcement and prosecution is having laws and regulations that are clear and understandable. Enforcement officials told us that some legal cases involving the illegal traffic of hazardous waste have been stayed or have not proceeded, on the grounds of difficulties stemming from the definitions used in the *Canadian Environmental Protection Act* and the *Export and Import Hazardous Wastes Regulations*.

4.74 Moreover, the prosecutions that did proceed were generally settled prior to trial, with small amounts being paid in settlement. Consequently, the full legal impact of the EIHW Regulations has not been demonstrated through precedents established by successful criminal prosecution with meaningful sanctions.

4.75 The Canadian Council of Ministers of the Environment (CCME) is working to resolve some definitional problems. Environment Canada has centered its efforts on co-operation with the provinces, development of harmonized national definitions and criteria for hazardous waste movements within Canada, in parallel with related international activities. Environment Canada reported that the work being done by the CCME on the definitions of hazardous waste is largely related to federal/provincial harmonization rather than to solving issues relating to effective enforcement.

4.76 We concluded that timely resolution of these complex definitional issues will be an important prerequisite to more effective enforcement. We also concluded that, to date, Environment Canada has made reasonable efforts in co-operation with the Canadian Council of Ministers of the Environment to harmonize federal/provincial definitions of hazardous waste. We support Environment Canada's efforts in this area.

4.77 **Other constraints.** Exhibit 4.6 illustrates some constraints to effective enforcement. For example, a unique tariff number would improve the ability to develop intelligence information and use it to target inspections. The World Customs Organization is working to address this issue in close co-operation with the Basel Convention

Secretariat and the OECD Secretariat. The Commission of Environmental Co-operation, which involves Canada, the United States and Mexico, is working on the development of a North American Tracking System to better control transboundary movements of hazardous waste within North America.

Exhibit 4.6

Constraints to Effective Enforcement

Environment Canada	Customs Border Services
<ul style="list-style-type: none"> • Limited enforcement resources • Limited broad-based sanctions (e.g. only warnings) other than prosecutions • Lack of sampling, equipment, intelligence infrastructure • Cultural reluctance to embrace enforcement • Definitional issues 	<ul style="list-style-type: none"> • Lack of intelligence information from Environment Canada • Customs officials need enhanced training • Lack of a unique tariff number assigned to hazardous waste hampers ability to develop effective targets • Limited facilities for inspections

4.78 With regard to sampling at the border, Environment Canada stated that the effective taking and testing of samples of illegal imports is difficult considering the volume of traffic at border crossings and the variety of substances (some 3,200) that are potentially hazardous waste, and the limited time that shipments can be detained at the border.

4.79 Beyond the use of warning letters, no other broad-based sanctions, such as ticketing, are currently available other than prosecution. Without the ability to use administrative sanctions, there are no broad-based alternatives other than formal prosecution, which involves preparing court briefings and going through the court system.

4.80 Operational enforcement personnel repeatedly advised us that they believe there is a cultural reluctance to embrace enforcement within Environment Canada. We acknowledge that there are essentially two different philosophies that underpin the achievement of compliance with the law and enforcement. The first is based on promoting compliance through increased awareness and education. The second is to focus on deterrence through enforcement actions, including successful prosecution. Environment Canada stated that it is attempting to strike a balance between both philosophies. We were told this poses a dilemma for those charged with enforcement responsibilities under the Export and Import of Hazardous Wastes Regulations.

4.81 Overall, when we compared current practices with the practices described in Exhibit 4.3, we concluded that current enforcement operations have significant gaps in the areas of detecting illegal traffic at the border and providing a deterrent to illegal transboundary movements of hazardous waste.

4.82 The issue for Environment Canada to consider is, “How long does a regulation have to be in place to be vigorously enforced?” Environment Canada stated that these Regulations are relatively new regulatory instruments that have merited special effort in the development of compliance tools and compliance promotion. The Department stated that once the proper infrastructure is completed, it will strengthen its efforts in enforcing the Export and Import of Hazardous Wastes Regulations. This means that, effectively, it will have taken almost five years for the Department to put in place a robust enforcement program for these Regulations. We note that shippers were required to comply with the Regulations as soon as they first came into force in 1992.

Canada Does Not Know the Extent to Which It Is Living Up to Its International Obligations to Prevent Illegal Traffic

The inherent difficulty of controlling exports

4.83 High volume of border crossings. It is inherently difficult to reconcile the need to control exports with the need to facilitate free trade at Canada's 6,000-km border. Given this inherent dilemma, we expected that once Environment Canada committed to these international agreements and their associated obligations, it would consider whether the export controls were enforceable and the options for enforcing these obligations. For example, one option could be to improve the timely exchange of information between Revenue Canada and the United States Customs Service.

4.84 Prior to the ratification of the Basel Convention, Environment Canada stated that the enforceability of the Export and Import of Hazardous Wastes Regulations had been considered, as outlined in the Regulatory Impact Analysis Statement, and this among other things gave rise to the Memorandum of Understanding between the Department of Environment and Revenue Canada Customs.

Limited facilities to deal with exports

4.85 In the bulletin issued by Customs Border Services on the Export and Import of Hazardous Wastes Regulations, exporters of hazardous waste are instructed to leave a copy of their documentation (letters of authorization, notice forms and the manifest) in a collection box at the port of exit. We observed that efforts by Customs officers are hampered by the limited facilities to deal with exports. We also observed during our visits that there was limited effort by Customs officers to monitor compliance or to encourage compliance by truckers at the export lanes. At some locations there was no collection box, or any other facilities to deal with exports. In our opinion, these constraints make it extremely difficult to track and monitor compliance with the EIHW Regulations. Without this ability, Canada is not in a position to know the extent to which it is living up to its own regulatory requirements with respect to the collection of the export documentation, as well as its international obligations with respect to the export of hazardous waste.

4.86 Memorandum of Understanding silent about exports. The Memorandum of Understanding (MOU) signed between Environment Canada and Revenue Canada Customs Border Services requires Customs Border Services to collect a copy of the waste manifest for imports. However, on Customs' responsibilities to collect the documentation required for exports, the Memorandum is silent. In our opinion, this is a significant omission that needs to be rectified to clarify both accountability for collecting export documentation and the level of effort to be invested in controlling exports at the border.

Revenue Canada Customs Border Services and Environment Canada's joint comment: *The Memorandum of Understanding between Revenue Canada and Environment Canada will be reviewed by both departments and an amendment made to include a provision that an appropriate level of effort will be established for exports relative to the degree of risk. In addition, the MOU will be reviewed by both departments in its entirety to determine if further amendments are required. The review will include, but is not limited to, the sharing of intelligence information, collection of documents and detainment of shipments. It is expected that this review, including a revised draft MOU, will be completed by 31 March 1998.*

Intelligence Data for Profiling and Targeting Illegal Traffic Are Key

Information not yet shared with all parties

4.87 The need for timely information. When we visited the regional offices of both Environment Canada and Customs Border Services, we were consistently advised by their regional officials that they needed timely information from Environment Canada headquarters to use as a starting point for profiling and targeting illegal shippers, particularly information relating to the manifesting system.

4.88 Over the last two years, a new, more flexible database system has been developed and implemented to meet the needs of government users and clients. Environment Canada believes that the new computerized tracking system should be better able to accommodate modifications that enhance the availability, accessibility and usefulness of the data collected. This information could be used to profile and target potential illegal shippers. We compliment the Transboundary Movement Division of Environment Canada on these important initiatives and encourage it to continue.

Limited intelligence infrastructure at Environment Canada

4.89 Sharing of sensitive material is based on mutual trust. In all three regions we visited, we found that the Intelligence officers at Customs Border Services are not provided with information available at Environment Canada. This information is needed to enhance/develop their own intelligence data in order to better target Customs' detection efforts at the borders as well as its investigations. The Enforcement Branch at Environment Canada is aware of this problem but the Department does not currently have the necessary intelligence-gathering capacity to provide the information.

4.90 Grass-roots efforts to create better intelligence data. In our regional visits to Environment Canada and Customs Border Services, we did find localized efforts to begin to create the required regional intelligence infrastructure. For example, in the Ontario region, those responsible for enforcement have used their own intelligence information to successfully prosecute illegal offenders. In the Quebec region, personnel at Customs Border Services, including the marine divisions, have stated that they could integrate hazardous waste into their ongoing targeting program with no additional personnel if they had better intelligence information from Environment Canada.

4.91 Environment Canada should fulfill its stated responsibilities under its Memorandum of Understanding with Revenue Canada Customs Border Services to provide intelligence information to Revenue Canada Customs Border Services to be used for targeting and inspections.

Environment Canada's response: Agree. Environment Canada is taking steps to provide all currently available information to Revenue Canada Customs Border Services for it to use for targeting. Environment Canada will also strengthen its co-operation with other departments and agencies for the implementation of the Export and Import of Hazardous Wastes Regulations, including provincial governments, Interpol, the RCMP, U.S. EPA, U.S. Customs and appropriate agencies of the United States.

Interaction with other departments and agencies needs to be strengthened for hazardous waste

4.92 The proven advantages of a joint force operation. We were consistently told in our field visits, both within Canada and in the United States, that a joint force operation approach was the best way to maximize interaction among the regulators, the enforcers, the prosecutors and others interested in ensuring compliance with rules on the transboundary movements of hazardous waste. These joint forces exist at many levels of government,

and at levels of all the relevant organizations. Such an approach is currently used successfully to interdict illegal imports of drugs, illegal exports of strategic materials, stolen cars, etc.

4.93 The key players. The most important agencies with which Environment Canada could interact include:

- Revenue Canada Customs Border Service officers (who help administer and enforce the regime at the border);
- the RCMP, provincial and municipal police;
- federal, provincial and municipal officials dealing with transportation of dangerous goods;
- federal, provincial/territorial and municipal hazardous waste officials who administer regulations governing waste management and disposal; and
- international agencies.

4.94 Progress in some regions. We observed that the use of a joint force operation approach is still in its infancy in the regions. In the Pacific Region, Customs Border Services and Environment Canada have a good working partnership. Both participate in the Co-ordinated Law Enforcement Unit (CLEU), a joint force operation organized by the Province of British Columbia, Ministry of Attorney General. Other key members of this unit are the U.S. Customs Service, the provincial Ministry of Environmental Protection and Conservation, the RCMP and Transport Canada. In our view, this joint force operation approach is one that merits further attention.

4.95 Overall, we concluded that Environment Canada is not maximizing the likelihood of detecting illegal activities because it is not taking a proactive approach that makes effective use of intelligence data from various sources. We also concluded that Environment Canada has not yet developed and co-ordinated its enforcement efforts with respect to the Export and Import of Hazardous Wastes Regulations, recognizing and incorporating the work of the various domestic organizations focussing on hazardous waste traffic.

4.96 For the Export and Import of Hazardous Wastes Regulations, Environment Canada should provide the necessary leadership to establish a joint force operation approach that will capitalize on the existing expertise within Environment Canada, Customs Border Services, the RCMP and others with key enforcement roles, both at headquarters and in the regions.

***Royal Canadian Mounted Police's response:** The RCMP investigates criminal violations of the Canadian Environmental Protection Act in conjunction with Environment Canada. We fully support the joint forces approach in these matters and the continuous sharing of information alluded to in the chapter. It is believed the RCMP can further support Environment Canada in environmental law enforcement efforts by enhancing the assistance given in the areas of criminal intelligence and international criminal investigations. In fact, our agencies are presently extensively involved at the international level through Interpol and its Environmental Crime Working Party.*

***Environment Canada's response:** Agree. Environment Canada will enhance its ability to collect in a proactive way pertinent information from other agencies and will capitalize on its experience and expertise as well as that of others, to ensure appropriate compliance and enforcement of the Export and Import of Hazardous Wastes Regulations.*

Leadership and Co-ordination of International Activities

Canada is an active player

4.97 Environment Canada is providing leadership. Canada has been actively involved in international activities to develop and maintain the international regime of controlling transboundary movement of hazardous waste. Although funding of the Basel Convention Secretariat by member governments has been an issue, Canada has consistently paid its share of funding in full, and on time.

4.98 Environment Canada has been leading and co-ordinating the negotiation of Canada's international obligations concerning the transboundary movement of hazardous waste. Our interviews with other government departments revealed that they believe Environment Canada is doing a credible, professional job in this area.

More information and analyses for decision making required

4.99 The proposed ban. As discussed earlier, the Government of Canada is facing a decision on whether to ratify a recent amendment to the Basel Convention that would ban shipments of hazardous waste recyclables from developed to developing countries. This decision involves two key elements: an immediate ban on shipments of material intended for final disposal; and a ban by 31 December 1997 on hazardous waste shipments destined for recycling or recovery. We were advised in our interviews that the first element is generally supported by most stakeholders but that the second element is more controversial.

4.100 Information and analysis for decision making. Sound decision making about the potential policy trade-offs associated with the proposed ban on shipments of recyclables will require solid information and analysis of the issues. Notably, we expected to find analysis of:

- the environmental impacts associated with a ban on shipments of recyclables;
- Canada's potential economic interests in developing country export markets for recyclable waste; and
- how Canada might address any potential inconsistencies between its international environmental and trade policies and obligations.

4.101 The environmental analysis. Canada is on record that it will not consider ratifying the ban decision taken by the global community under the Basel Convention until the technical issues associated with the definition of hazardous waste have been resolved. In its response to the review of the *Canadian Environmental Protection Act* by the Standing Committee of the Environment and Sustainable Development, the Government of Canada has agreed to amend the *Canadian Environmental Protection Act* to clarify the authority to make regulations to ban exports and imports of hazardous waste to and from any country, when required under international agreements to which Canada is a party.

4.102 Once the definitional issues are resolved, Environment Canada should determine whether it needs to analyze both the positive and negative environmental effects of the proposed ban, as it will relate to the new revised list of hazardous wastes.

Environment Canada's response: Once the lists of hazardous wastes have been finalized by the Technical Working Group under the Basel Convention, Environment Canada will carry out an assessment of risk posed by such wastes when exported to facilities that do not operate in an environmentally sound manner.

4.103 The economic analysis. Records indicate that Canada has not authorized any shipments of hazardous waste for recycling to a developing country, but concern has been expressed about the loss of potential future opportunities for such shipments. We would think that federal government departments expressing these concerns would have encouraged a process to analyze the economic issues. While some analysis has been done, we found that these other government departments had not completed an integrated, cross-sectoral, forward-looking analysis consistent with the concerns they had expressed. The lack of an agreed-upon definition is a constraint to completing this analysis.

4.104 International trade and environment policy analysis. We found that trade policy concerns have been expressed about the proposed ban. There was some concern about inconsistency between the Basel Convention ban decision and Canada's trade obligations. However, we were not provided with a comprehensive analysis of this issue. While some analysis is being done, we were not provided with a comprehensive analysis to indicate how Canada might remedy any potential inconsistencies between its policies and obligations, in keeping with Canada's stated view that liberalized trade and environmental protection are, in principle, mutually compatible and indeed supportive.

4.105 Decision making. We concluded that such analysis would be of assistance to the government in making a decision on the ban on shipments of recyclable hazardous waste. We concluded also that to facilitate decision making in the future, this analysis should be integrated into a process to establish a coherent and forward-looking strategic plan for future activities under the Basel Convention. We are supportive of Environment Canada's leadership initiatives in this complex area.

Conclusion

4.106 The primary objective of this audit was to determine whether Environment Canada, in co-ordination with other federal departments and other provinces, has established an effective and comprehensive regime to control the transboundary movement of hazardous waste consistent with Canada's international commitments. Environment Canada has made a good start in establishing such a regime but, as noted in this chapter, there are still some significant deficiencies. Relative to the audit's sub-objectives as shown in **About the Audit**, we concluded that:

- Environment Canada has yet to take appropriate enforcement action with regard to detecting illegal traffic in hazardous waste at the border and establishing the required intelligence capacity necessary for proactive prevention of illegal shipments. This is not the first time this Office has noted problems in the area of enforcement. In 1991 we reported that priorities for enforcement and compliance had not been clearly defined and that enforcement and compliance activities were not well monitored and evaluated.

- Environment Canada plays a leadership role, both domestically and internationally, in the area of the transboundary movement of hazardous waste.

- Environment Canada promotes and monitors compliance with the Export and Import of Hazardous Wastes Regulations. It has established and operates the notification and manifest systems, which are an important component of Canada's response to meeting its international obligations. During the introduction of the regulations, Environment Canada's compliance promotion activities were done well.

- Environment Canada is promoting efforts to harmonize federal and provincial definitions of hazardous waste.

4.107 In an area such as controlling the transboundary movements of hazardous wastes, the chain is only as strong as the weakest link. In our opinion, as a result of the significant gaps in the areas of prevention, detection and enforcement and the limited facilities to physically control exports of hazardous waste at the border, Canada is not

in a position to know the extent to which it is living up to its international obligations with regard to preventing illegal traffic at the border.

Environment Canada's response: The Department concurs with the Auditor General's observations.

Canada is fully committed to meeting its international obligations concerning transboundary movements of hazardous wastes, and consequently, the Department has identified the enforcement of the Export and Import of Hazardous Wastes Regulations as a priority.

The Department is committed to working with other countries that have concerns regarding the prevention and detection of illegal traffic of hazardous waste, and will undertake to do so within the Basel Convention and Interpol.

The proposed revision to the Canadian Environmental Protection Act will go a long way to ensure that Canada has a rigorous regulatory regime to meet its international commitments regarding the transboundary movements of hazardous wastes.

About the Audit

There is growing global awareness that managing with due regard to sustainable development means minimizing waste, or preventing the creation of hazardous waste in the first place. This audit is part of a series of audits dealing with the issue of waste minimization and what the federal government is doing to manage the environmental risks posed by hazardous waste.

The focus of this audit was on the main element in the federal regulatory regime for hazardous waste, the Export and Import of Hazardous Wastes Regulations (EIHWR) promulgated under the *Canadian Environmental Protection Act* (CEPA). Future audits will deal with compliance promotion and enforcement of other federal environmental legislation such as the *Canadian Environmental Protection Act* and the *Fisheries Act*, as well as other pieces of environmental legislation that the federal government is accountable for enforcing.

Objective

The primary objective of this audit was to determine whether Environment Canada, in co-ordination with other federal departments and the provinces, has established an effective and comprehensive regime to control the transboundary movement of hazardous waste consistent with Canada's international environmental commitments and obligations to ensure environmentally sound and efficient management of such wastes.

There were four audit sub-objectives: to determine whether Canada is meeting its commitments and obligations under international agreements; to determine the extent to which Environment Canada plays a leadership role, both domestically and internationally; to determine the extent to which Environment Canada promotes and monitors compliance and takes appropriate enforcement action; and to look at efforts to harmonize federal and provincial definitions of hazardous wastes.

Scope and Approach

The audit examined the leadership provided by the Hazardous Waste Branch, Transboundary Movement Division at Environment Canada with regard to international environmental agreements. Interviews were conducted at Environment Canada, Natural Resources Canada, Industry Canada and Foreign Affairs and International Trade. The audit also included a review of the Division's work to develop harmonized Canadian definitions of hazardous waste, as well as the Division's role in compliance promotion activities. The audit focussed on the enforcement activities undertaken by Environment Canada at head office by the Enforcement Branch, Environmental Protection Services, as well as activities in the regions. Detailed audit work was done at the Canadian/U.S. border crossings that have the highest known volume of legal hazardous waste exports and imports: Lacolle, Quebec; Sarnia, Ontario; and, on the Pacific highway, British Columbia. The objective of these field visits was to determine the extent to which the regulations under the federal Export and Import of Hazardous Wastes Regulations, as well as international obligations, are being administered at border crossings. During these field visits we conducted field work at Revenue Canada (Customs), speaking with Customs inspectors at the border as well as intelligence officers responsible for profiling illegal shippers of hazardous waste. In these regions we also interviewed Environment Canada personnel responsible for enforcing these regulations. Our work excluded interviews

and examination of documents in areas of provincial jurisdiction. Our work also excluded transboundary movement of hazardous wastes by air.

The scope of this audit excluded areas of the domestic regulatory regime under provincial jurisdiction, such as the regulation of transportation of hazardous waste within provinces as well as the provincial regulation of the management of wastes of all kinds, including hazardous wastes. This audit also excluded the transportation of hazardous wastes within Canada.

Criteria

We expected that Environment Canada could demonstrate that Canada is fulfilling its international commitments and obligations with respect to the transboundary movement of hazardous waste. We expected that the Department could demonstrate that the different elements of Canada's regime for controlling transboundary movement of hazardous waste are supportive of efforts to improve the sound management of hazardous waste and waste minimization. With regard to the leadership role of Environment Canada, we expected that the Department would demonstrate federal leadership, by developing national policies, setting national standards and managing issues related to the transboundary movement of hazardous waste across Canada's borders. With regard to enforcement and compliance, we expected that the Department would inspect shipments, monitor to verify compliance and investigate suspected violations of the regulations and ensure appropriate deterrence of violations. We expected that when an investigation confirms a violation the Department could ensure that corrective action is taken. With regard to co-ordination with the provinces, we expected that the Department would assess areas of overlap and duplication and, where appropriate, develop appropriate approaches to minimize such overlap and duplication, and develop strategies to fill any gaps.

Audit Team

John Affleck
Frank Barrett

For information, please contact Wayne Cluskey or Dan Rubenstein, the responsible auditors.

Chapter 5

Reporting Performance in the Expenditure Management System

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Reporting Performance in the Expenditure Management System

Assistant Auditor General: Maria Barrados

Responsible Auditor: John Mayne

Main Points

5.1 Information on how well programs are doing is needed to make informed decisions on how to spend tax dollars and improve programs, and to demonstrate to Parliament and Canadians what they are getting for their taxes. Often, neither the public nor members of Parliament, or managers, have this information. The focus has too often been on describing the services delivered, rather than their results.

5.2 The federal government is in the process of revamping its Expenditure Management System, the process by which it plans, budgets and seeks parliamentary approval of future expenditures. The changes create an incentive for departments to develop better information that helps managers provide more effective programs to Canadians and inform Parliament in a more timely way about the results of their activities. Some Canadian provinces and governments abroad have already made important strides toward providing their legislatures and citizens with better information about the performance of government programs.

5.3 Progress has been made by several departments, and we found instances in which performance information reported to Parliament addressed many key aspects of performance reporting. In particular, we found improvement in the information's orientation to results. But to fully realize the potential, departments need to describe expected performance more clearly and concretely — that is, in more measurable terms. The account they give of performance needs to focus more on the benefits for Canadians. This will take time.

5.4 Further progress requires strong leadership by the Treasury Board Secretariat and senior departmental managers. The Treasury Board Secretariat has implemented positive innovations in a short period of time, but needs to improve the consistency of the assistance it provides to departments as well as its efforts to document and communicate good practices in measuring and reporting performance.

5.5 The role of parliamentary standing committees is vital to continued progress. If committees ask for information on the results of government activities and visibly use the information in their deliberations, departments will have a powerful incentive to collect and report the information.

Introduction

A Need for Information on How Well Programs Are Doing

Information on performance is required for good management and effective governance

5.6 Knowing how well programs and services are doing is increasingly essential to managing today's public sector, as governments here and abroad face resource reductions and a citizenry that continues to want good value from its government. Credible information on the results being achieved is needed for three reasons:

- **To manage tax dollars better.** Government expenditures are being reduced, but many Canadians still feel they are overtaxed. It is therefore more important than ever that tax dollars be spent efficiently and effectively. Ministers receive a range of information to consider in making decisions on future spending and priorities. Information on what current spending is accomplishing needs to be a key element of advice, particularly when resources for new initiatives must be reallocated from existing expenditures. Managers need timely information on what is working and what is not so they can direct resources to where they are most effective.
- **To make better decisions.** Officials need this kind of information on performance for the many day-to-day decisions they must make to manage effectively the programs and services provided to Canadians.
- **To provide for better accountability.** Canadians are demanding greater accountability from their governments. Trends in public opinion show a reduced confidence in government and, in a recent survey, the item most often cited as necessary for improved governance was accountability for measured results and effectiveness. Increasingly, Canadians are asking for better information on what they and their country are getting for their tax dollars; members of Parliament have expressed frustration at the lack of this kind of information. Moreover, with governments seeking alternative ways of delivering programs and services that involve other levels of government and voluntary and private organizations, credible information on performance is needed even more to ensure that tax dollars are being spent well.

5.7 The government has committed itself to creating a management culture that is fact-based, results-oriented, open and accountable. As we suggested in the chapter "Matters of Special Importance" in our November 1996 Report, openness and candor about the performance of programs will help to build public trust. We also suggested that progress in providing credible performance information has often been hindered by insufficient will and inadequate demand for such information. Strong leadership is needed to make measurement and reporting of results an integral part of public sector management.

Other jurisdictions report on accomplishments

5.8 Many jurisdictions are making visible efforts to provide their legislatures and citizens with better information about the performance of government programs. In Canada, in addition to the federal government, a number of provinces have moved in this direction. Appendix A outlines the reporting regimes in Alberta, Nova Scotia and New Brunswick as examples. Abroad, quite a few countries have moved to improve reporting of the performance of their governments as a whole and of individual departments and agencies. Appendix A briefly describes the cases of the United Kingdom and Australia, as well as the United States federal government and the states of Oregon, Texas and Minnesota.

5.9 We did not examine the success of initiatives undertaken in other jurisdictions or assess the extent to which better performance information is being provided than is the case in Canada. However, the experience reported by these jurisdictions shows that although providing performance information is not easy, it can be done. It is also clear that several years will be needed to fully implement initiatives to improve performance reporting.

What is “performance”?

5.10 The concept of performance deals with how well things are done:

- Were the expected results accomplished?
- Were they accomplished within budget and in the most efficient manner?
- Were there undue, unintended consequences?

It also deals with whether the performance achieved will continue or improve:

- Is the organization learning and adapting?

5.11 Performance, then, covers a number of ideas, and determining the specific aspect of performance to measure, and when, is not straightforward. Government programs undertake a number of **activities** that produce a variety of products, services, benefits and other impacts and effects (see Exhibit 5.1). We refer to these collectively as the **results** achieved. Programs deliver two kinds of results: **outputs**, the direct products and services produced by government activities, such as an unemployment cheque or some requested information; and **outcomes**, the impacts and effects of those outputs on Canadians and our society, including fair and equitable treatment. Outputs are results that managers can control, while the outcomes managers are trying to accomplish are influenced by factors outside their programs.

Exhibit 5.1

(This exhibit is not available, see the Report)

5.12 Outcomes can range from **intermediate outcomes**, such as changes in the actions of program clients and their satisfaction with a service, to more long-term or **ultimate outcomes** such as general improvements in the well-being of Canadians, the economy or the environment. Intermediate outcomes are more easily linked to the activities of a program than are ultimate outcomes.

5.13 Exhibit 5.2 illustrates how the various results of an anti-smoking program could be characterized. Another example can be found in Chapter 10 of this Report, which presents a diagram of results for an activity providing information on energy efficiency (Exhibit 10.5).

Exhibit 5.2

An Anti-Smoking Program

Result Type	Specific Program Result*
Outputs	<ul style="list-style-type: none"> • anti-smoking advertisements and promotions • educational material distributed

	<ul style="list-style-type: none"> • enforcement of smoking regulations
Intermediate Outcomes	<ul style="list-style-type: none"> • compliance with regulations • reduced number of smokers in total • reduced numbers of new smokers
Ultimate Outcomes	<ul style="list-style-type: none"> • reduced incidence of smoke-related health problems and deaths • reduced costs of health care associated with smoking-related problems
<p>* <i>Performance expectations</i> for these results would be the desired performance levels or changes, expressed, for example, in numbers or percentages for a given time period and target audience.</p>	

Knowing how well programs are working is a challenge

5.14 Complex programs mean that expectations must be clear. Federal programs operate in a complex environment. They often have to deal with a diverse and uncertain number of external factors and other players with similar or competing objectives. Moreover, they do not operate in a stable environment; change is now the norm. Furthermore, programs are trying to accomplish broad public objectives reflecting the public interest, which sometimes can be a challenge to measure.

5.15 Different individuals with different expectations about what a program is supposed to accomplish can reach different conclusions about how well the program is doing. Assessment of actual performance requires the establishment of a standard for comparison, such as a specified level of expected performance. These standards ought to be clearly stated as meaningful **performance expectations**.

5.16 Information on a program's performance must be gathered. In some cases, individuals can assess the direct service that each has received — such as assistance in submitting income tax returns, employment guidance or an import permit for a commercial shipment. But more information is needed to assess the overall success of a program, such as whether it ensures that Canadians pay their fair share of taxes, or adequately reduces the risk to specific endangered species. The managers of the programs need the same information if they are to manage for results. Gathering and assessing the relevant data and information requires systematic effort.

5.17 Information on program performance is an essential part of the process by which the government plans, budgets and seeks parliamentary approval for future expenditures. This process is the expenditure management system.

The Expenditure Management System Has Been Revised

A focus on results of programs in a world of no new resources

5.18 Expenditure management in the federal government during much of the 1980s and into the early 1990s was characterized by numerous, relatively small, across-the-board expenditure cuts and occasional freezes on expenditures. At the same time, managers were given access to policy and operational reserve funds, albeit in diminishing amounts. Although cumulatively the incremental reductions were significant, expenditure growth was not contained.

5.19 Moreover, the expenditure management system did not meet basic information needs. Our 1990 study of efficiency in government found that the planning and accountability documents required at that time often did not contain information pertinent to managing for efficiency. A year later, we noted that it was hard to manage by results when few meaningful ways to measure them had been put into use.

5.20 Revisions introduced in 1995. The revised Expenditure Management System (EMS) was announced in 1995 in the context of the government's aim to reduce the deficit to three percent of GDP. In the 1995 publication "The Expenditure Management System of the Government of Canada", the President of the Treasury Board noted that "the old ways [of managing expenditures] clearly [did] not work in a time of severe fiscal restraint." A key feature was to "improv[e] information on program performance to aid decision-making and facilitate accountability." Another key feature was the elimination of central policy reserves to fund new initiatives, since "central policy reserves did not encourage the ongoing review of existing programs and spending." New initiatives were to be funded through reallocation of existing resources. The Program Review the government undertook in 1994 identified specific programs and services to be reduced or eliminated.

5.21 As we have reported in the past, previous attempts at gathering and reporting performance information have met with limited success. None, however, was driven by the current need to make difficult spending choices and to gather support for reducing expenditures.

A framework for the revised Expenditure Management System

5.22 The main features of the revised EMS were contained in a document tabled in the House of Commons in February 1995. Subsequently, additional refinements have been developed and are being implemented, sometimes on a pilot basis. Exhibit 5.3 identifies the various documents and processes that make up the Expenditure Management System.

Exhibit 5.3

(This exhibit is not available, see the Report)

5.23 From Parliament's perspective. Phase II of EMS reform (Phase I was the introduction of Business Plans described in paragraph 5.29), known as the Improved Reporting to Parliament Project, is intended to improve the expenditure management, planning and performance information that goes to Parliament. The major changes are in the Estimates documents and the way they are dealt with by Parliament.

5.24 The Estimates are currently in three parts: Part I, the overview of government spending; Part II, the proposed appropriations; and Part III, detailed expenditure plans for each department and agency. The intention now is to split Part III into two new documents:

- a *Report on Plans and Priorities*, tabled in the spring in conjunction with Parts I and II of the Estimates, and intended to establish performance expectations and outline the general direction the minister wants the department to take during the estimates year and the next two fiscal years; and
- a *Performance Report* tabled in the fall for the period at least up to the previous 31 March, and intended to provide information on results actually achieved in serving Canadians both as clients of specific services and as taxpayers.

5.25 Both of these new reports would be Estimates documents, tabled in the House and referred to the appropriate standing committees.

5.26 In addition, the government is testing an In-Year Update to Parliament in the fall as a complementary document to Supplementary Estimates, noting any significant changes in either the financial or non-financial figures tabled the previous March in the Main Estimates for the current year.

5.27 The timing of the spring plans and fall Performance Reports is intended to enhance the role of standing committees. Fall Performance Reports enable committees, in a timely way, to report their conclusions to the House and to make their views known to the government as it carries out its fall budget consultations. Standing committees may thereby influence spending plans and priorities of the next or subsequent years. Similarly, spring plans may provide a focus for committee reporting to the House on future years' plans and priorities, facilitated by 1994 changes in House rules.

5.28 The key milestones in the Improved Reporting to Parliament Project are outlined in Exhibit 5.4. The Outlook documents mentioned in the exhibit were introduced in response to the February 1994 changes in House rules and will be subsumed by the Reports on Plans and Priorities. Sixteen pilot Performance Reports were tabled in the fall of 1996 (see Exhibit 5.5 for a listing of these departments). Pilot Reports on Plans and Priorities were tabled in the spring of 1997 by these departments, along with the 1997-98 Main Estimates.

Exhibit 5.4

Milestones in the Improved Reporting to Parliament Project

Spring 1995	Treasury Board Secretariat initiates project. Parliamentary Working Group established. Departments provide Outlook documents to their respective standing committees.
June 1995	Subcommittee on Business of Supply of the Standing Committee on Procedure and House Affairs established.
November 1995	The first annual report of the President of Treasury Board to Parliament tabled.
December 1995	House of Commons motion concurs with report of Standing Committee on Procedure and House Affairs, agreeing to Estimates Part III pilot project.
March 1996	Six departments table pilot 1996-97 Estimates Part III. Remaining departments provide Outlook documents.
April 1996	Forum on Performance Reporting - members of Parliament, pilot departments, the Auditor General, Treasury Board Secretariat officials.
June 1996	Evaluation report on pilot Estimates Part III recommends splitting planning and performance information into separate documents. House concurs with report of Standing Committee on Procedure and House Affairs, agreeing to extend pilot to include departmental Performance Reports and an In-Year Update, and to expand to 16 departments.
October 1996	Sixteen departments table pilot Performance Reports for the fiscal year ended 31 March 1996. President of Treasury Board tables annual report with Annex B - Key results commitments by departments.
November 1996	In-Year Update tabled for the 16 pilot departments.
December 1996	Evaluation report on the 16 fall Performance Reports.
February 1997	Reports on Plans and Priorities tabled for the 16 pilot departments. The remaining departments table revised Estimates Part III, along the lines tabled in March, 1996.

Exhibit 5.5

The Pilot Departments

The following 16 departments and agencies led the implementation of improvements to performance reporting in the Expenditure Management System. They agreed to be the first to table Performance Reports in Parliament, in the fall of 1996:

Agriculture and Agri-Food Canada

Atlantic Canada Opportunities Agency

Environment Canada

Fisheries and Oceans

Immigration and Refugee Board

Indian and Northern Affairs

National Energy Board

National Parole Board

Natural Resources Canada

Revenue Canada

Royal Canadian Mounted Police

Statistics Canada

Status of Women

Transport Canada

Treasury Board Secretariat

Veterans Affairs

5.29 Within government, business plans are being prepared. An integral element of the EMS is the Treasury Board requirement for departmental Business Plans to be submitted to the Board for review, in place of multi-year operational plans. Business Plans are concise, strategic, three-year plans that set out goals, targets and performance measures. Several provinces, including Alberta, Ontario, and New Brunswick, also have adopted this approach.

5.30 The intention of the government is that Business Plans are to be the main planning document of departments and submitted to Treasury Board ministers. Although these are not public documents, the public Reports on Plans and Priorities will integrate the business planning information with other reporting requirements established by Parliament.

5.31 An important element of the revised EMS entails departments moving to a comprehensive, results-focused accountability structure for reporting financial and non-financial information, known as the Planning, Reporting and Accountability Structure (PRAS). The PRAS relates the internal management and accountability regime of the department to its objectives, business lines, resource requirements and performance targets. It is intended to provide the basis for reporting in Business Plans and Estimates documents.

Focus of the Audit

5.32 Because of the length of time needed to make major changes and the need to adapt to changing circumstances, implementation of the revisions to the Expenditure Management System is ongoing. We could have waited until the system was fully mature before auditing in this area. However, we decided that it would be more

useful to communicate clearly our expectations and assessment of progress at this time, so that they can contribute to the ongoing implementation of the system.

5.33 We undertook the audit to assess the progress departments are making in their reporting of expected and actual performance in the Expenditure Management System. We also sought to identify examples of good reporting practices that exemplify our expectations (set out in detail in Appendix B). These expectations were developed in consultation with the Treasury Board Secretariat. They are based on our assessment of experience in Canada and other jurisdictions. We identified five characteristics needed to give a credible account of performance:

- clear context and strategies;
- meaningful performance expectations;
- accomplishments reported against expectations;
- demonstrated capacity to learn and adapt; and
- fair and reliable performance information.

5.34 Because of the newness of changes in this area, we did not expect to see all of these expectations for good reporting reflected in all of the performance information now provided in the revised Expenditure Management System. The audit focusses on information about non-financial, rather than financial, performance provided in key documents that form part of the Expenditure Management System. Chapter 2 of this Report, “Financial Management: Developing a Capability Model”, and Chapter 3, “Management of the Government’s Accounting Function: A Central Agency Perspective”, deal with financial matters.

5.35 We also examined the role played by the Treasury Board Secretariat in implementing innovations to encourage better reporting of information on performance, and the use made of this information by parliamentary standing committees. Full details on the conduct of the audit can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

Revised Estimates Framework Shows Potential for a Greater Focus on Results

More opportunities for standing committees to comment on results

5.36 An emphasis on results. Communications about the revisions to the Expenditure Management System and related Estimates documents emphasize an important message — the need for departments to make available information on what programs are intended to achieve and what they are accomplishing.

5.37 Separate reports fit the budget cycle better. Information contained in the Main Estimates submitted to Parliament each spring by the government is the basis for parliamentary approval of resources the government requires for the coming fiscal year. The Estimates contain a mix of financial and non-financial information that covers past expenditures and accomplishments, year-to-year financial reconciliation, and planned expenditures and activities. By separating information on future plans from information on past performance, especially in the fall

Performance Reports, the new framework draws more attention to the performance achieved by programs. It also provides performance information on previous fiscal years five to six months earlier than before, serving as timely input to budget consultations.

5.38 In-Year Update potentially provides better information on changes to expectations. Supplementary Estimates are requests for changes to program funding in the Main Estimates. In November 1996, an In-Year Update report covering the 16 pilot departments was tabled, to test a way of complementing Supplementary Estimates by providing better information to Parliament on significant adjustments to program priorities, expectations, and changes in planned spending. The In-Year Update is intended to make Parliament more aware of program changes that have significant impacts on Canadians. We assessed the nature of the departmental input to the In-Year Update and found that none reported changes to expected performance, although some had proposed significant resource changes. The Report did provide some helpful information on resource reallocation that would not be evident in the Supplementary Estimates.

Promising improvements in accessibility of information

5.39 Improved timing of reports is, in itself, not sufficient to make information useful. We also expected the information to be organized and presented so that it is easily understood and the reader can readily access other desired information.

5.40 Promising improvements in accessibility through information technology. Treasury Board Secretariat staff are working with departments and the House of Commons to improve the electronic distribution of pilot documents. The intention is to use the Internet as the main tool for electronic communication of these documents to all MPs, their staffs, and the public. To date, the pilot Performance Reports, the In-Year Update report, the 1997-98 Reports on Plans and Priorities and all Estimates Part III are available through the Internet at <http://www.tbs-sct.gc.ca/tb/rpem/homee.html>. The intention is to continue this practice. In addition, the Review Information Network of the Secretariat Internet web site (http://www.info.tbs-sct.gc.ca/rin_hm_e.html) contains information on hundreds of recent reviews of various aspects of performance of selected programs.

5.41 A Parliamentary Working Group on the Improved Reporting to Parliament Project was convened to give feedback on proposed improvements to the expenditure management information provided to Parliament. The Working Group reports that members of Parliament support the move to electronic reporting. The offices of all MPs and Senators are currently connected to the Internet. Although Treasury Board Secretariat officials have consulted with the House of Commons and with departments, parliamentary staff believe that better co-ordination of detailed implementation is needed in the future. For example, the format used by the Secretariat to make Performance Reports available on the Internet is not suitable for some systems. A continued partnership between the House of Commons and the Treasury Board Secretariat will help to ensure that the Members' needs are met and that information is distributed in a timely and effective manner.

5.42 Shorter, more readable documents. Parliamentarians have complained about the excessive amount of information in the Estimates Part III. The proposed framework for reporting to Parliament would address this by providing briefer documents that focus on key strategies for at least the current and next two years.

5.43 We assessed the structure and readability of the pilot Estimates Part III and the fall Performance Reports and compared our assessments with those contained in Treasury Board Secretariat evaluations of the documents. In most cases, our Office and the Secretariat found that the documents were shorter and more readable and used better communications techniques than previous Estimates Part III. Parliamentarians consulted during the Secretariat's evaluations of the pilot Estimates Part III and the fall Performance Reports found the separation of planning and performance information helpful and the documents more focussed and clearly organized than the previous Estimates Part III.

5.44 Need more links to detailed information. Users of information on departmental performance may sometimes need more detailed information than is provided in shorter documents. Although parliamentarians have complained about excessive information in the Estimates Part III, they and their staffs have also observed that there may not be enough detail on specific topics of interest. Balancing these concerns requires that documents provide links to more detailed information. The pilot Estimates Part III and the fall Performance Reports of some departments contained some references to sources of more detailed information. However, in many cases there was no consistent and systematic use of such references.

5.45 The Treasury Board Secretariat intends that departments will electronically link Expenditure Management System documents on the Internet to more detailed sources of information. Consistent with recommendations in our 1992 study of information to Parliament, this would allow for shorter printed documents and lower costs than with printed distribution, while providing easy access to additional information where needed. Electronic linkage is not expected to be completed for two years.

5.46 Departments should ensure that their reports contain appropriate references to more detailed sources of information.

Need for a formal means to ensure that improvements continue

5.47 The current reporting framework has been brought about through administrative changes and motions in the House, and implemented only on a pilot basis. Although these can be successful approaches, neither has the force and permanence of legislation.

5.48 Other jurisdictions report some success with accountability legislation. A number of other jurisdictions with systems of government similar to the Canadian federal government, including Alberta, Western Australia and New Zealand, as well as the U.S. federal government and a number of state governments, have made use of legislation that requires departments and agencies to report on their accomplishments. (Appendix A provides some information on several of these jurisdictions.) These planning and reporting regimes, while established through legislation, are similar to that being implemented in the Canadian government.

5.49 Some Canadian federal entities have legal reporting requirements. Since 1984 the accountability framework for federal Crown corporations has been contained in Part X of the *Financial Administration Act*. The Act requires the tabling in Parliament of summaries of corporate plans that set out corporate objectives and expected performance, and annual reports that indicate actual performance against those objectives. Since then, our audits have found improvements in information presented to Parliament on the performance of Crown corporations, although further improvements are still required. Some other organizations have specific legislated reporting requirements. For example, enabling legislation for the Atlantic Canada Opportunities Agency requires it to evaluate its activities and “report on the impact [its] activities have had on regional disparity.” Since the 1987 legislation, the Agency has reported considerable information on the impact of its two main programs. Yet, as we reported in 1995, improvement still needs to be made in the reported information. We also reported that the Atlantic Canada Opportunities Agency is taking steps to build on what has been learned. We have not audited the Agency’s performance information since that time.

5.50 Legislating government reporting requirements is not enough on its own to ensure the quality of performance reporting or the appropriate use of the information by legislatures. Several other essential factors are listed by the United States General Accounting Office, which identified five key challenges:

- developing and sustaining commitment by top management;
- building the capacity of agencies to implement the legislative framework and use the resulting performance information;

- creating incentives to implement the framework and to change the focus of management and accountability;
- integrating the framework into daily operations; and
- building a more effective legislative oversight approach.

5.51 These are also challenges in Canada. Previous audits have shown that the government needs to build the capacity to measure and assess the performance of its programs and services. The chapter “Matters of Special Importance” in our November 1996 Report suggested that improving the information available on results has rarely been a high priority of the government, noting that in several other jurisdictions that have made advances in reporting performance, political leaders have been the driving force. Finally, it is critical that mechanisms exist that provide for members of Parliament, committees and government to consider and make effective use of performance information.

5.52 The progress observed in the initiatives to date needs to be continued if their potential for better reporting and use of information on performance is to be realized.

5.53 **The government, with Parliament’s agreement, should ensure that the improvements in the reporting regime implemented on a pilot basis are made a permanent and formal feature of the Expenditure Management System covering all departments and agencies, and should seek parliamentary approval for incorporating these improvements in the business of supply.**

Progress in Describing the Department’s Business

5.54 We expected the performance plans and reports to provide an overview of what departments are trying to accomplish under what circumstances, and the relationship of individual programs to broader organizational goals and commitments to the public. This information would allow the reader to interpret the program performance that is reported, and it is needed to help manage programs and make decisions about the allocation of resources.

In many cases, descriptions of departments have improved

5.55 Treasury Board Secretariat evaluations of the pilot Estimates Part III and fall Performance Reports observed that, in most cases, members of Parliament and their staffs found the overviews of departmental functions, structures and main activities better than in the past.

5.56 **Improved descriptions of mandate and mission.** We found that most departments provided clear descriptions of mandate and mission. The best of the mission statements were related to departmental business lines and contained a clear vision of an ideal outcome toward which the department was striving.

5.57 **Limited improvement in breadth of stewardship information.** We noted in our 1992 study on departmental reporting that the existing Estimates documents focussed on annual spending and consequently did not often report on the other instruments departments use to meet the objectives of the programs they deliver — in other words, global stewardship. Regulations, loan guarantees and tax expenditures are some common examples of these other instruments. We recommended that the government report on the broader stewardship responsibilities and not just on annual spending. In 1994, we expanded on this concept to include the need for a lead department for overall reporting of activities that are delivered by more than one department. We, as well as parliamentary staff, expect that departments would at least refer to other government activities that bear on the outcomes they are trying to achieve. For example, Indian and Northern Affairs Canada provided in its fall Performance Report some financial information on other federal departments dealing with First Nations. We note that Treasury Board Secretariat guidelines point to the need to include material on global stewardship.

5.58 However, Performance Reports showed no clear overall improvement in the provision of such information on global stewardship. The references to non–spending instruments, when made, are generally included as supplementary financial information and are not incorporated into the general discussion of the department’s context, business lines and strategies. We recognize that some of the information needed to report on global stewardship is beyond a department’s direct responsibility — for example, many tax expenditures. However, where this is the case, we would expect, as a minimum, a short discussion of the extent of the use of such instruments and their impact on the outcomes the department is seeking.

5.59 Departments should include in their performance reporting reference to related activities elsewhere in government, as well as a discussion of all the key instruments that they use to achieve their objectives, including those instruments that are not reflected in estimates of spending for the coming year.

Progress in Orientation of Results Expectations, but Need for Greater Clarity and Concreteness

5.60 We expected performance plans to provide an understanding of what the department intends to achieve, by when, and at what cost. We looked for a focus on major intended results of key programs, especially on outcomes that represent the value received by program clients and other Canadians from government activities. This information would assist members of Parliament in their scrutiny of future departmental spending and is needed by managers to control their programs. It is essential for reporting performance.

Expectations focus more on outcomes

5.61 **Good progress in establishing outcome–oriented expectations.** We compared performance expectations set out in the spring in the Estimates Part III and the Business Plans of 11 departments with those subsequently set out in the fall in departmental Performance Reports and in Annex B of the Annual Report to Parliament by the President of Treasury Board, “Getting Government Right: Improving Results Measurement and Accountability”. In the majority of the cases, we found the focus on outcomes was greater in the fall than in the spring. Overall, of the more than 600 expectations set out in Annex B of the President’s Report in the fall, more than half were for outcomes. We consider this to be good progress toward a focus on outcomes.

Expectations need to be clearer and more concrete

5.62 Statements of expectations need to indicate clearly what would have to occur for a program to be judged successful, given the department’s mission and the program’s objectives and activities. They need to be expressed concretely in terms that permit measurement. The measurement can involve numeric estimations of magnitude or “softer” forms of measurement, such as the solicitation of users’ views. However, if the expectations are not clear and concrete, they are not useful for assessing how well a program is doing.

5.63 **Few statements of clear and concrete expectations.** Our assessment of the performance expectations stated in the President’s Report and fall Performance Reports found some that were specific enough to give a clear picture of desired results (Exhibit 5.6 gives a few examples).

Exhibit 5.6

Examples of Clear but Not Concrete Performance Expectations

Agriculture and Agri–Food Canada made a commitment to:

“high compliance rates for federally inspected products and federally registered establishments.”

Source: *Getting Government Right: Improving Results Measurement and Accountability*. Annual Report to Parliament by the President of the Treasury Board, 1996, page 16

Canadian Heritage commits itself to:

“new national parks and historic sites and related protected areas”.

Source: *Getting Government Right: Improving Results Measurement and Accountability*. Annual Report to Parliament by the President of the Treasury Board, 1996, page 18

5.64 While they are clear, however, these expectations are not concrete: one does not know when things are to occur or exactly what level of performance is needed to fulfill the commitment. A better approach to establishing clear expectations is to set specific targets, as illustrated by the Atlantic Canada Opportunities Agency and Revenue Canada (see Exhibit 5.7). The Atlantic Canada Opportunities Agency, in particular, stood out as having set a large number of targeted outcomes, and while it did not do so in all cases, in many instances it indicated its contribution to changes in the outcomes.

Exhibit 5.7

Examples of Clear and Concrete Performance Expectations

The **Atlantic Canada Opportunities Agency**, reporting on its efforts to create jobs and generate income in Atlantic Canada, set as targets:

achieving “an ‘intent to start business within 2 years’ index of 17% by 1998” and

“in partnership with rural communities of the Atlantic region, creating and maintaining 3,600 jobs over three years through lending and counseling activities of the Community Business Development Corporations (CBDCs).”

Source: *Atlantic Canada Opportunities Agency Performance Report*, for the period ending March 31, 1996, pages 27-28

Revenue Canada undertook to:

“reduce Income Tax accounts receivable levels to 4% of gross Income Tax revenues by March 1997”.

Source: *Revenue Canada Performance Report*, for the period ending March 31, 1996, page 8

5.65 Where targets have not yet been established, expectations need at least to set out the expected direction of improvement in performance, as demonstrated in Exhibit 5.8. About one fifth of the expectations reported in Annex B of the President’s Report did so. However, indicating the direction of improvement does not tell the degree of change that would have to occur, and by when, for the performance to be judged successful.

Exhibit 5.8

Examples of Expectations That Indicate the Direction of Improvement

Agriculture and Agri-Food Canada expects that its Inspection and Regulation activities will result in an:

“increased number of countries/markets accepting Canadian agri-food products”.

Source: *Getting Government Right: Improving Results Measurement and Accountability*. Annual Report to Parliament by the President of the Treasury Board, 1996, page 16

Royal Canadian Mounted Police expects:

upward trends in clearance rates of Criminal Code offences.

Source: *Royal Canadian Mounted Police Performance Report*, for the period ending March 31, 1996, page 9

5.66 We compared the clarity and concreteness of expectations set out in the fall with those in the spring, for 11 departments. We found some improvement in clarity, but little improvement in concreteness.

5.67 Overall, we found that the nature of performance expectations varied considerably. Some were general statements of goals to be achieved, some were descriptions of the activities that programs were going to carry out, others were lists of planned performance indicators, and still others were actual targets against which performance could be assessed. This was especially true of the results commitments set out in Annex B to the President's Report. The wide range of the commitments stated in the Report makes it difficult to compare departments and suggests that there was a need for clearer guidance on what these statements should have been.

5.68 Clear and concrete statements of expected results would allow actual performance to be assessed. Establishing expectations that are reasonable and measurable and that clearly indicate what results can be expected of a program can be a challenge. Any given department may be successful at meeting this challenge for some areas of activity but not for other areas. Overall, with a few notable exceptions, the performance expectations set out in the fall did not include targets and many were not specific. Many were too ambiguous to allow us to determine the anticipated result.

5.69 Exhibit 5.9 provides a few examples of imprecise performance expectations. These examples are intended to be illustrative and should not be taken as an indication of the overall progress of these departments toward setting clear expectations. Nor should they be taken as an indication that these departments have made more or less progress, overall, than others toward setting clear expectations.

Exhibit 5.9

Examples of Imprecise Expectations

Statistics Canada commits itself to relevance of statistics as demonstrated by:

“their use in the redesign of health care policies and programs”.

Source: *Statistics Canada Performance Report*, for the period ending March 31, 1996, page 8

Royal Canadian Mounted Police commits to provide Canadians with protection against organized crime by:

“successful partnerships with other agencies engaged in combatting organized crime”.

Source: *Royal Canadian Mounted Police Performance Report*, for the period ending March 31, 1996, page 9

Canadian Heritage commits to promoting:

*“opportunities to enjoy Canada's heritage areas”.**

Source: *Getting Government Right: Improving Results Measurement and Accountability*. Annual Report to Parliament by the President of the Treasury Board, 1996, page 18

* Department officials state that their first Performance Report will provide information that will clarify this expectation. The Department was not one of the 16 that prepared pilot Performance Reports in the fall of 1996.

5.70 In these examples, only a very general expectation is stated. It is difficult for readers to understand in advance how much of exactly what is expected to occur, unless additional detail is provided. For example, although Statistics Canada has taken an important step in identifying a final outcome that may result from its statistics, the “redesign of health care policies and programs” could be satisfied by quite minor changes in a single aspect of a

health service being delivered, or could require substantive changes to health care in Canada, depending upon the perspective of the reader. In its Performance Report, Statistics Canada discusses processes in place to monitor the utility and relevance of its products, and it may be able in the future to provide more specific information about accomplishments in this area. However, the kind of general expectations shown in Exhibit 5.9 inherently create a potential for disagreement about whether or not they have been met.

5.71 Performance indicators often not clearly explained. A performance indicator is the kind of information actually used to assess a specific aspect of performance. In some instances, Performance Reports clearly identified and explained the kind of information that would be used. For example, Exhibit 5.10 shows how the RCMP explained the meaning and pertinence of the “clearance rate”.

5.72 However, we found instances where it was not evident what the performance indicator was measuring or why it was being reported. Revenue Canada, for example, in discussing the performance of its Customs Border and Trade Administration Services, presents several indicators, including “Compliance Rate”, expressed as a percentage, under the heading “Travellers”. Although the compliance rate may be a good outcome-oriented indicator, the Performance Report provides no explanation of what the rate includes. The other two indicators are not defined either. However, the 1996-1997 Estimates Part III for Revenue Canada did provide brief definitions of these indicators. As another example, many departments refer to “client satisfaction” without explaining satisfaction with what, and how it will be determined.

Exhibit 5.10

Example of Clearly Defined Performance Indicator

RCMP

“Historically, the effectiveness of a police organization has been evaluated in terms of its ability to dispose of reported offences. This measurement is expressed as a clearance rate which represents the ratio of the number of offences cleared to the number of actual offences. ‘Clearance rates’ can be used to demonstrate how effectively the RCMP deals with the incidence of violent crime cases within its jurisdictions.... Clearance rates include those cases in which an ‘actual’ offence has been committed, where the offender is known, and sufficient evidence has been uncovered to support the laying of a charge.”

Source: *Royal Canadian Mounted Police Performance Report*, for the period ending March 31, 1996, page 21

5.73 In some cases, where departments did not report clear and concrete indicators of performance, they identified indicators they plan to use or areas for which they are developing indicators. This is a good practice. For example, Environment Canada announced that it was developing measures of its impact on the consideration of sustainability in energy decisions and on environmental stress caused by transportation. Statistics Canada proposes to develop an indicator to measure the average burden that responding to its surveys places on individual Canadians. It currently reports the average “response burden” on all businesses.

5.74 Departments should establish clear and concrete statements of the performance expected from their lines of business. These should be included in their Business Plans, Reports on Plans and Priorities, and Performance Reports.

Some Progress in Reporting Accomplishments, but Still Cannot Judge Success of Programs

Some performance reporting meets many of our criteria

5.75 We expected to see progress in the reporting of accomplishments in relation to expectations. At its best, performance information provides a credible account of how well a department has done. This account needs to focus on outcomes related to key expectations. It ought to describe what the department is trying to achieve and

what it contributes to that end, given the influence of other actors and outside factors. We also would expect the account to show that the department has accepted responsibility for results by taking action to address weaknesses in performance. Finally, it ought to be made credible by indicating the extent to which the reader can rely on the information presented. Appendix B outlines our expectations in more detail.

5.76 We examined the reporting of accomplishments in the fall Performance Reports. The best examples provided many of the key elements for reporting performance, but not all of them.

5.77 For example, Transport Canada's reporting on its aviation safety activities did not provide concrete performance expectations, nor did it comment on the reliability and validity of the performance indicators used. However, it did provide the general objectives of the Department's aviation activities, a clearly explained outcome-oriented indicator (accident rates), a limited description of the activities the Department undertakes to influence the outcome and a discussion of the limitations on its ability to link its activities to the safety of the aviation system (Exhibit 5.11).

Exhibit 5.11

(This exhibit is not available, see the Report)

Need more progress in reporting key accomplishments

5.78 Reporting of performance accomplishments needs to be selective to be usable. We expected that the fall Performance Reports would focus on the key intended results, especially outcomes, and key or significant programs or program elements. We also expected some reporting against previously stated expectations.

5.79 In 11 departments, we compared the reporting of outcomes in the fall Performance Reports with reporting in the spring 1996-97 Estimates Part III. We found some improved reporting of outcomes in the majority of these 11 departments between the spring and the fall.

5.80 Nevertheless, our examination of the 16 fall Performance Reports found that much progress was still needed in the reporting of outcomes. Although departments reported some intermediate and few ultimate outcomes, overall there were many instances where outcomes were not identified. However, expectations established in the past tended to focus on outputs rather than intermediate or ultimate outcomes. We observed a greater emphasis on outcomes in the performance commitments reported in the President's Report of fall 1996. This may lead to greater reporting of intermediate and ultimate outcomes in the future.

5.81 Even when outcomes were reported, the general lack of clear and concrete expectations made it impossible to judge how well most programs were doing.

5.82 **Emphasis on activities and outputs.** In interviews conducted by the Treasury Board Secretariat, officials in most departments said that although they are committed to better measurement of results, actual reporting is still oriented toward activities and outputs. Of the departments that said they are moving toward reporting results, all but one acknowledged that their reporting focusses on outputs and that much work remains to be done to move toward reporting outcomes. When we examined the fall Performance Reports, we found that the emphasis was on describing activities undertaken and their outputs. Although some description of activities and outputs is essential to a credible account of performance, the picture is not complete if outcomes are not addressed. In the future, we will report on the obstacles departments encounter in moving toward increased measurement and reporting of outcomes.

5.83 **Reporting is often on details.** Some staff responsible for departmental planning and reporting have said that strategic reporting — that is, reporting that focusses on key activities and results — is difficult because all managers want their own programs and activities included. But if reporting is to be strategic and focussed, it must be selective and not cover all aspects of a department in detail. For some departments, performance reporting was

not always strategic, focussing on detailed lists of activities undertaken within business lines or on details of administrative and management matters. This reduces the readability and increases the length of reports. Decreasing the discussion of these details would allow departments to address elements of performance reporting that need more attention.

5.84 Departmental performance reports should be more strategic, providing a better account of the key aspects of performance.

The department's contribution not frequently made clear

5.85 The vast majority of departments did not show how their reported achievements related to their activities. Nor did they clearly describe or discuss their contribution to outcomes in comparison with the contributions of other parties. Although a few departments provided information that gave some understanding of their own contribution to their intended outcomes, none did this consistently well.

5.86 We realize that determining the contribution made to an outcome can be a challenging task. Nevertheless, reporting on the performance of key outcomes ought to recognize the other factors that may be influencing an outcome, describe how the program's activities are intended to influence the outcome sought and highlight any available evidence supporting the contention that the program is having an impact. This need not be a lengthy text; its purpose would be to explain to the reader why the program is thought to make a difference. Where little is known about the extent of the contribution, this ought to be acknowledged. Performance in controversial areas might, at some point, need more formal program evaluation studies to assess the program's influence.

5.87 Reluctance to report results that cannot be fully controlled. In our discussions with program managers, they sometimes indicated an unwillingness to report on results that they could not fully control. Managers are less likely to have full control over outcomes than over outputs. The Treasury Board Secretariat's evaluation of the fall Performance Reports observed that in 10 departments, managers stated that the inability to attribute outcomes directly to departmental efforts was a major factor affecting their reporting of results.

5.88 This problem needs to be addressed. Departments ought to be giving a credible account of their performance, discussing — with the evidence available — the contributions they are making to all key outcomes, even those over which they do not have complete control. Few departments have attempted to do so.

5.89 Departments should describe how the activities of their programs contribute to the reported outcomes.

More attention needed to the fairness and reliability of performance information

5.90 To be considered and used, performance information needs to be understandable and credible. Credibility requires information that is understandable, reliable and valid — that is, information that is verifiable and measures what it purports to measure.

5.91 Balanced reporting enhances credibility. Some managers may want to avoid criticism by reporting only performance that has met expectations. Doing so, however, can lead to Performance Reports that lack credibility because they appear to be just “good news stories”. Indeed, this was the view expressed by some of the parliamentarians interviewed as part of the Treasury Board Secretariat's evaluation of the Performance Reports. More balanced reporting is essential if the information is to be credible and used outside the department.

5.92 For the most part, the pilot Performance Reports focussed on positive accomplishments, with limited or no attention paid to areas where expected results were not being achieved. Where expectations are not clear (as was common), it is difficult to judge whether programs are accomplishing enough.

5.93 Nevertheless, we found several instances where departments did enhance the credibility of their Performance Reports by describing performance that had not met expectations. Exhibit 5.12 shows Environment Canada's description of shortfalls in bringing back threatened species.

Exhibit 5.12

Example of the Reporting of Performance That Does Not Meet Department's Expectations

Environment Canada

Expected Result: *"Positive recovery trends for designated threatened or endangered species are achieved."*

Statement of Performance: *"Generally speaking, Environment Canada has achieved notable results with such migratory species as Porcupine Caribou and duck and geese populations, and it has brought species such as the whooping crane back from the brink of extinction. Nevertheless, an increasing number of species are listed as either endangered or threatened. Despite significant progress in the protection of special spaces, the total area protected remains short of the 12% national goal and there remain many gaps in the national network of protected areas."*

Source: *Environment Canada Performance Report*, for the period ending 31 March, 1996, pages 16 and 18

5.94 Departments can adopt one of two constructive approaches to reporting performance that is lower than expected. They can report actions planned to improve performance or, where expectations are no longer feasible and appropriate, indicate changes in those expectations.

5.95 Reporting corrective actions that are being taken. Departments can acknowledge areas where performance goals were not met, and indicate what they have learned about the reasons for the performance gap and what corrective action they plan. This demonstrates a balanced approach to performance reporting and proactive management. It is perhaps where there is no evidence of having learned from experience that criticism is most warranted about performance that has not met expectations.

5.96 We found a few examples of reporting that both identified problems and discussed what was being done to address them. For example, Transport Canada's Performance Report recognized that the system of public harbours and ports suffers from overcapacity and too much bureaucracy, and it promised that a policy would be implemented to correct the situation. The Atlantic Canada Opportunities Agency reported that it had dropped a loan program after evidence had shown it to be not very effective. Another example was Statistics Canada, which reported that it was restructuring surveys in response to studies of the strengths and weaknesses of its energy, retail, wholesale and manufacturing statistics.

5.97 Revising expectations. In some cases, performance may not meet expectations because the expectations are no longer feasible or appropriate in light of current circumstances. In these cases, departments could update their stated expectations and provide the rationale for doing so. We found no instances where departments clearly reported changes in expectations.

5.98 Where performance does not meet expectations, departments should report the performance gap, the reasons for it and the changes they are making to close the gap.

5.99 Credibility requires accurate information. To be credible, information presented in Performance Reports must be reliable and valid. Furthermore, we expected that reports would indicate the information's reliability and validity — where the reader may question it — by describing, for example, the method of data collection and verification, the accuracy of the data, their relevance and significance, and related factors also influencing the performance reported. We would also expect any limitations in the reliability of the data to be reported.

5.100 Few departments presented information of this type to indicate the extent to which their reporting of performance can be relied upon. For example, the source of outside information needs to be presented, allowing for a determination of its reputation. Environment Canada took this approach by indicating whether the Department itself or a reputable professional journal was the source of information used to report progress in controlling emission of ozone-depleting substances.

5.101 Unintentional and relatively minor errors in reporting can nevertheless be damaging to the credibility of a department's Performance Report. We verified the accuracy of reported information in only 18 specific instances, where we expected to find good performance information that could be used as examples in this chapter. This was not a representative sample of either the reports or the information in them. In verifying the information, for the most part we did not audit the sources of the information in detail.

5.102 We assessed the methodology used to develop the reported information and assessed the consistency of the information with that contained in the original sources. In almost half of these instances we found problems, including errors in reporting or calculating numbers and inadequately qualified reporting. The errors are mostly minor and did not result in misleading statements. However, they do point to the need for better procedures to check the performance information being reported.

5.103 **Departments should provide, where appropriate, an indication of the strengths and weaknesses of reported information and their implications for the reported performance. They should develop and implement procedures to ensure credibility and accuracy of the information reported.**

Little information on interdepartmental and horizontal issues

5.104 In her Fourth Annual Report to the Prime Minister on the Public Service of Canada, the Clerk of the Privy Council and Secretary to the Cabinet observes that horizontal policy issues — ones that cut across a number of departments — are growing in number. The Report also notes that tackling these issues requires an expanded knowledge base and increased interorganizational collaboration. We have commented in the past on weaknesses in the availability of information on the results of interdepartmental and horizontal activities. There is still a need for a mechanism to ensure that requirements for information on interdepartmental and horizontal performance are identified and addressed and that the performance is reported. The reports that make up the information base of the Expenditure Management System are mostly provided by individual departments and therefore do not contain information on interdepartmental and cross-government aspects of performance.

5.105 In the President's Report to Parliament for 1996, the Treasury Board Secretariat announced that it would be working with Statistics Canada and other departments and agencies to develop a set of core government-wide performance indicators that could be used for future reporting. An interdepartmental committee has been established, and work is under way. Progress is to be reported in this year's President's Report. Establishing a set of government-wide indicators would be one way to report on horizontal and interdepartmental performance. As illustrated in Appendix A, a number of other jurisdictions have moved significantly in this direction and now regularly report against a set of global performance expectations.

A Vital Role for Treasury Board and Its Secretariat

5.106 The Treasury Board Secretariat plays a key role in the Expenditure Management System. We expected that it would ensure a reasonable rate of progress in improving performance reporting within the EMS. Ensuring reasonable progress requires that the Secretariat provide adequate guidance and direction to departments and agencies and follow through with supportive action. It also requires that it foster a climate for credible performance reporting by showing leadership, demonstrating commitment, providing incentives, facilitating the building of expertise and developing a capacity to learn and adapt. It is important that the Secretariat recognize the challenges

faced in implementing system-wide changes of this size, and capture and act on the lessons learned in order to better manage change in the future.

Treasury Board Secretariat has implemented important innovations in a short period of time

5.107 Change has been rapid, making the job difficult. The Treasury Board Secretariat has moved quickly to implement revisions to the Expenditure Management System. Rather than implementing all the revisions at once, it has taken a phased approach that includes trial implementation of innovations in departments at each phase of the budget cycle, building on the experience gained in previous phases. The Secretariat consulted extensively with parliamentarians, this Office, departments and other stakeholders.

5.108 Changes during implementation have been rapid and frequent, and sometimes confusing for departments, who told us they would have liked more information earlier on how the components of the EMS fit together. Secretariat analysts also found the changes confusing. The initiatives were being implemented at a time of considerable internal change in the Secretariat.

5.109 Steps have been taken to provide guidance and direction. In order to ensure that expenditure management documents meet the needs of Parliament and government, expectations and standards for these documents have to be communicated to the departments that prepare them. The Treasury Board Secretariat has issued guidelines for EMS documents, conducted extensive consultations with departments and provided feedback on draft documents. As part of this audit, we examined the EMS guidelines. We found that they encourage departments to establish and report against expectations for performance. They also encourage a strategic focus on results and outcomes. The guidelines for the fall Performance Reports included principles for performance reporting prepared by this Office in consultation with the Secretariat.

5.110 To develop the performance expectations in Annex B to the President's Report, Secretariat analysts reviewed departmental performance and planning documents and identified an initial set of expectations. These were then presented in the form of "mock-ups" and were discussed with departments. Most departments were able to further improve their performance expectations based on this guidance. We found this approach to be particularly effective in encouraging a greater focus on outcomes.

5.111 We noted that guidance to departments and agencies on the preparation and presentation of financial information in performance plans and reports was limited to the structure of the tables to be included. We believe that better guidelines would help ensure that financial information is more complete, reliable, clearly and fairly presented, and prepared on a basis consistent with the government's stated accounting policies.

5.112 Consistency in the provision of guidance and direction is important. When trying to implement considerable change in a short period, it is particularly critical to convey consistent messages. Although the written guidelines are reasonably consistent, departments told us and the Secretariat that they had received inconsistent advice and feedback as they prepared the new reporting documents. Secretariat analysts acknowledged some inconsistencies in the responses they provided to departments. The guidelines were revised several times in response to feedback and as experience was gained. Requirements for the content of EMS documents were added or changed up to a few weeks before deadlines. While this might have allowed for the most up-to-date guidance to be provided, departments sometimes perceived the changes to be confusing.

5.113 The Secretariat advises us that it has taken measures to resolve this problem by co-ordinating all advice on performance reporting through teams previously established to co-ordinate the development of Business Plans. However, experience in the development of the 1996 Business Plans has shown that the approaches taken by those teams vary considerably. It remains to be seen whether this approach will address the concerns of departmental officials.

5.114 The Treasury Board Secretariat should ensure the consistency of advice and feedback provided to departments on performance reporting.

5.115 Training and development initiatives have been implemented. Moving to a more results-based approach to management is a major change for most programs. There is a considerable need for education and training in how to develop useful measures of performance and how to use them in managing and reporting. This is an important departmental responsibility, but the Treasury Board Secretariat has a role to play as well. The Secretariat undertook a number of initiatives to provide additional guidance and to develop the required expertise in departments. These included sponsoring many workshops over the past two years at the Canadian Center for Management Development; holding workshops with groups of departments; briefing departments and their executives; and holding or co-sponsoring sessions to review experience with such innovations as departmental Outlook documents, pilot Estimates Part III and Business Plans. The sessions included departments and the users of performance information, including this Office. Some included members of Parliament. In general, we found that the training and review sessions encouraged a focus on results, including outcomes.

5.116 Measures have been taken to learn and adapt. On behalf of the Parliamentary Working Group, the Secretariat has conducted evaluations of pilot Estimates Part III and fall Performance Reports. We agreed with the evaluation conclusions except for the assertion, reported in the evaluation of the pilot Estimates Part III, that performance expectations were set out well in the documents. Treasury Board Secretariat management has agreed with the recommendations flowing from the evaluations of the pilot Estimates Part III and the fall Performance Reports. Appendix C summarizes the key recommendations of these evaluations; we agree with those recommendations.

5.117 We interviewed Secretariat officials and reviewed available documentation to assess the progress made in implementing the recommendations and related commitments to action. Some of the recommendations address matters that fall outside the time frame of this audit; in almost all remaining areas, the Secretariat has made progress. We found that Secretariat officials have used the results of the evaluations to modify their approaches, develop training and guidance, make recommendations to management and support the development of motions for consideration by the House of Commons.

5.118 The Secretariat has also evaluated both the 1995 and 1996 business planning processes. We did not examine TBS implementation of recommendations from these evaluations, many of which fall outside the scope of this audit.

5.119 Better identification of good practices is needed. In the past, departments have expressed concern that the rigidity of requirements for reporting in the Expenditure Management System has not allowed them to communicate clearly the department's business and context. The current approach adopted by the Treasury Board Secretariat responds to this concern by allowing considerable flexibility in the format and content of expenditure management documents. Instruction is in the form of general guidelines rather than directives, and requirements are few. Some departments, however, indicated that they need more help in preparing their documents than the guidelines provide.

5.120 We believe that identifying and communicating examples of good practice — not only for reporting performance but also for identifying expectations, measuring results and using the results to improve programs — is an excellent way to provide guidance. The evaluation recommendations reflect this principle. At the federal level in the United States, documenting cases of good practice is an important part of implementing the legislated performance reporting regime. Our audit found that there are instances of good practice that can be identified and communicated.

5.121 Treasury Board Secretariat has encouraged departments to share good practices as a means to develop the needed expertise. The Secretariat played a more active role in the development of Annex B to the President's Report by providing individual mock-ups, which identified expectations that analysts thought suitable. The most recent

Canadian Centre for Management Development workshop on reporting of results also adopts a proactive approach to communicating good practices. Nonetheless, considerable improvement in performance reporting is still required. We believe that more documentation and communication of good practices is needed to help departments produce better information on what they have accomplished.

5.122 The Treasury Board Secretariat should strengthen its effort to document and communicate good practices by departments in articulating performance expectations, measuring results, and using the information to improve programs and report accomplishments.

Departments need to see that the Treasury Board and its Secretariat use performance information

5.123 Measuring and reporting on results will take hold in government only if the information is found to be useful to program managers and seen to be useful to senior government decision makers. Use by others outside the departments can play a key role in encouraging a focus on results. When the Treasury Board and its Secretariat use or demand information on results, they demonstrate commitment and leadership and provide key incentives to continue improving the reporting of results. Departmental officials have told us that if they do not see performance information used in making decisions, it will be hard to justify efforts to improve reporting. At the time of this audit, it was too early to assess central agencies' use of the information in the fall Performance Reports.

5.124 The Treasury Board Secretariat's evaluation of the business planning process highlighted other problems. Secretariat analysts recognized that although Business Plans were used to provide a general context for resource and program design decisions, they had not used information in Business Plans as they had intended, especially to comment on interdepartmental and horizontal issues. Review of Business Plans by the Treasury Board came too late for some departments to make adjustments for the current year. Review was still ongoing for some departments in early 1997. Also, some departments did not get the feedback they desired from the Treasury Board on specific issues.

5.125 The Treasury Board Secretariat should ensure that individual departments are aware of Treasury Board and Secretariat use of performance information provided in the departments' Business Plans and Performance Reports.

A Leadership Role for Standing Committees

5.126 Parliamentary standing committees could play a leadership role in encouraging departments to manage for results, by asking for information on results and by visibly using it in their deliberations.

Standing committee use of performance information is important

5.127 Visible interest in, and use of, performance information by parliamentarians, especially standing committees, can have two benefits: first, if departments believe that committees want the information, they will likely devote more effort to providing better information; and second, parliamentarians will be better served by that information.

5.128 Increased, but still limited, use by some standing committees of the performance information provided by departments. Committee hearings were held in 1995 and 1996 on departmental Outlook documents, Estimates Part III, the pilot Estimates Part III and five of the fall Performance Reports. The Performance Reports were tabled on 31 October 1996, giving limited time for review before the House adjourned in December.

5.129 Departments have said that standing committees pay only limited attention to dealing with the accomplishments of programs. Our review of the documents from these hearings showed that there was a small

increase in references to and discussion of the performance information provided by departments. However, discussion of performance information provided to standing committees was still minimal.

Treasury Board Secretariat has actively involved Parliament

5.130 Early in the initiative, the Secretariat turned its attention to developing an understanding of the needs of parliamentarians. A Parliamentary Working Group met several times with Treasury Board Secretariat officials. Consultations also took place with other parliamentarians, including standing committee chairs and the chair of the Subcommittee on the Business of Supply of the Standing Committee on Procedure and House Affairs. The officials supported the process leading to the motions passed in the House in December 1995 and June 1996, endorsing the key stages of the initiative. As the project advanced, Secretariat staff explained the intent of the changes through briefings of standing committees and appearances as witnesses at committee hearings. In addition, information sessions and focus groups were conducted with parliamentary staff, including the research staff of the Library of Parliament and procedural clerks of the House of Commons.

Parliamentary use of performance information could be facilitated

5.131 As part of our audit work, we obtained the views and thoughts of a number of standing committee chairs about government efforts to improve information for Parliament and about the role their committees could play in fostering better management in government. They encouraged us to suggest ways that standing committees could be more effective in considering departmental performance information.

5.132 Current role for standing committees and MPs. The need to improve the parliamentary process for reviewing government expenditures has been widely recognized for at least 30 years, including in successive parliamentary committee reports. Members of Parliament have indicated three sources of frustration: the available information does not provide a reasonable perspective on performance; the volume of government activity makes in-depth review impractical; and, as noted in the 1993 Report of the Liaison Committee on Committee Effectiveness, MPs in standing committees see “little point in committing precious time to reviewing estimates that will not be modified as long as the government has a majority.”

5.133 Recently, action was taken to re-examine the parliamentary process for expenditure scrutiny. In June 1995 the Standing Committee on Procedure and House Affairs established a Subcommittee on the Business of Supply. This subcommittee was given a mandate to undertake a comprehensive review of the business of supply, with particular attention to the reform of the Estimates and to the related processes and mechanisms of the House and its committees. The subcommittee has issued several reports, supporting and providing guidance to the pilot projects associated with the Improved Reporting to Parliament Project. The subcommittee expects to issue its final report in early 1997.

5.134 Mechanisms for reporting to the House are important. Reforms in the mid-1980s allowed standing committees to report on all matters relating to the mandate, management and operation of the departments assigned to them, including program and policy objectives, expenditure plans and the departments’ effectiveness in meeting their objectives. Although this broad mandate applies to reports on priorities and performance, more specific measures can help, at times, to clarify the mandate. For example, in February 1994, amendments to the House Standing Orders facilitated committee review and reporting in the spring on expenditure priorities and plans for future fiscal years. That committees have not yet done so may be linked to parliamentarians’ lack of familiarity with the new documents and to limits on the time available to committees for review.

5.135 Review and reporting on the fall Performance Reports would provide another opportunity for committees to question and challenge spending plans and priorities of departments, based on what was accomplished in the preceding fiscal years. The 1994 rule changes clarified the power of committees to report on plans and priorities in

the supply process (now to be supported by the spring Reports on Plans and Priorities). New arrangements may be needed to facilitate committee reporting to the House on fall Performance Reports.

5.136 Performance plans and reports, unlike the now discontinued Outlook documents, are Estimates documents. Their formal tabling in Parliament and referral to committees will assist parliamentarians in two ways. First, members and committees will be made aware of these documents at an opportune time; and second, they will receive them in accordance with established parliamentary procedures. The fall 1996 Performance Reports were tabled with the President of the Treasury Board's Annual Report. This practice is expected to continue.

5.137 Timing of reports to Parliament is also important. Parliamentarians would have liked to receive Outlook documents (now part of the spring Reports on Plans and Priorities) and the Performance Reports earlier, to allow more time for review. In order to influence early budget discussions and departmental implementation of previous budget decisions, the spring Reports on Plans and Priorities need to be provided in time for review and reporting before the summer recess. For committee review to be part of the budget consultation process, Performance Reports would have to be provided as soon as possible after the fall session of Parliament begins. Exhibit 5.3 illustrates the timing of EMS documents and their potential review by committees.

5.138 Other jurisdictions are also trying to increase the involvement of legislators in reviewing performance information. We observed earlier that many jurisdictions have made progress in implementing initiatives to provide better performance information to their legislatures. They are also trying to find ways to make the review of this information more meaningful to legislators. New Zealand, the Australian states of Western Australia and New South Wales and the province of Alberta are four that have recognized the need to develop the capacity for legislators to use the information more effectively (see Exhibit 5.13).

Exhibit 5.13

Legislators in Other Jurisdictions Are Using Performance Information

New Zealand

In New Zealand, the Estimates state the government's objectives and, in the case of appropriations for goods and services, prescribe service performance measures and targets, although ministers generally do not report whether those targets have been met. Introduced early in the financial year, the Estimates are subject to a two-month period of examination by parliamentary select committees. Following 1996 rule changes, any MP is allowed to propose a change in the Estimates, which, if not vetoed by the government, must be voted on.

Government departments and other Crown-owned agencies provide Parliament with a report at the beginning of the year that includes a statement of projected service performance; actual performance is reported in their annual reports. The performance of all departments and agencies (including state-owned enterprises) is subject to parliamentary review and debate following the tabling of annual reports.

Western Australia

The statutory requirement in the state of Western Australia since 1985 for departmental non-financial performance reporting to Parliament has led to recognition of the need for legislators to use the information more effectively. The Standing Committee on Public Accounts and Expenditure Review of the Legislative Assembly (the lower house of Parliament) examined the reporting of performance indicators in 1991 and suggested adoption of a systematic approach to in-depth review by parliamentary committees. A royal commission argued in 1992 for a strengthened and broader use of the parliamentary committee system. Over the past four years, the Standing Committee on Estimates and Financial Operations of the Legislative Council (the upper house, in theory the house of review) has carried out an annual review of the Estimates, involving a comparison of objectives in Estimates documents with performance information in annual reports; the Committee has sought greater consistency between the two. The same Committee recently examined and reported on the issue of reporting performance indicators, and it recommended improvements in the process.

New South Wales (Australia)

The New South Wales Legislative Assembly established a Public Bodies Review Committee in 1995, with a mandate to examine the effectiveness of performance reporting in annual reports of all public bodies. State legislation explicitly requires that performance be

reported, and makes every public sector organization accountable for its performance. In its first year, the Committee formulated guidelines on what it intends to examine, and has developed a set of criteria for performance reporting. In future years, the Committee plans to examine a number of the annual reports issued each year, seeking to ensure that all agencies are moving toward best practice.

Alberta

In Alberta, a regular process for the review of departmental performance reports has been established. Legislative assembly committees on supply and public accounts examine, respectively, ministry business plans, which are tabled with the Estimates, and annual reports. In addition, five subject–area standing policy committees of Cabinet review business plans and annual reports in public sessions. These committees include backbench government members of the Legislative Assembly as well as Cabinet ministers. The initial sessions on annual reports in the fall of 1996 reviewed seven ministries, and developed a “report card” on the quality of the reports and on the extent to which performance expectations were being met.

Standing committees could ask a number of questions about departmental Performance Reports

5.139 Members of Parliament can expect that, over time, performance plans and reports will:

- explain the context and business of the department and its programs;
- discuss the strategies being used to meet objectives;
- explain what exactly is to be accomplished in the next year or two, and at what cost; and
- describe in a credible manner what has been accomplished in relation to previously stated expectations and at what cost, and what has been learned.

5.140 To focus attention on performance and results — on what Canadians are getting for their tax dollars — committees could ask the following types of questions:

Where reports provide information only on departmental activities (numbers of inspections, reports produced, etc.):

- What are the results of those activities? Why aren't those results reported?

Where performance expectations are vague or unclear:

- How will we know if and when those expected results actually occur?

Where accomplishments have been reported with no reference to a standard or some expected level of performance:

- Is the reported level of performance good enough? How can we tell? How much is left to accomplish and how long will it take? What is the department doing to improve its performance?

Where it is not clear how the program in question has contributed to the reported accomplishments:

- What has been the department's contribution? What other factors are acting that influence or limit the department's efforts? What has the department done to develop a clear understanding of its influence?

Where performance has been reported without some explanation of where the information came from:

- How reliable is the information? Why should we believe the information presented?

5.141 Committees could also provide feedback to departments by commenting on the content of the Performance Reports, including the suitability of the measures reported, and on their usefulness.

5.142 **Standing committees may wish to consider strengthening their review, challenge and use of performance plans and reports from departments. Government should work with Parliament to develop means for enhanced parliamentary use of departmental performance information as input to the budget consultations.**

Conclusion

5.143 We found that progress has been made in reporting departmental performance expectations and accomplishments to Parliament and central agencies through the revisions to the Expenditure Management System. These efforts need to continue and be given adequate time to mature. Improved reporting of performance information will take several years of experimenting and learning. The government, with Parliament's agreement, needs to ensure that the improvements made become a permanent and formal feature of the Expenditure Management System, and to seek parliamentary approval for incorporating these improvements in the business of supply.

5.144 Nevertheless, progress has been sufficient to allow us to find examples of good practice that, collectively, demonstrate that the key elements of adequate reporting to Parliament can be provided.

5.145 Although considerable improvement has been made in the reporting regime and in the clarity of communication, the content of performance expectations and reporting of actual performance still need to be improved. Reports need to focus more on key areas of performance so that the information required can be provided in documents that are short and readable.

5.146 It is important to maintain the progress we observed and to make more progress. To accomplish this, leadership by senior departmental management and the Treasury Board Secretariat is required. The Secretariat needs to strengthen the guidance and feedback it provides departments and its documentation and communication of good practices. As the Expenditure Management System continues to evolve, it is important that departments and the Treasury Board Secretariat ensure that the required capacities are present, including the co-ordination needed within these organizations and among organizations.

5.147 Progress will be significantly enhanced if departments clearly see use of performance information by the Treasury Board, its Secretariat, and parliamentary standing committees. More visible use by standing committees could be accomplished through stronger review by committees and a link to the budget consultation process.

Treasury Board Secretariat's comments: In 1995, the President in Chapter 1 of his report to Parliament, Strengthening Government Review, stated the government's commitment to "a management culture that is fact-based, results-oriented, open and accountable." Reporting on performance is a key element in the strategy to make these fundamental changes. It is also a key component of the Improved Reporting to Parliament Project. Accordingly, the government welcomes the Auditor General's support for this initiative.

Our strategy is to focus attention on clear commitments to results, to experiment with pilot reporting, and to involve program delivery and policy managers in measuring performance. The Auditor General's recommendations to departments and to the Treasury Board Secretariat are consistent with current actions and plans. As we move forward to extend fall performance reporting broadly to departments and agencies, we will be considering the Auditor General's recommendations, as well as parliamentary and public response to the reports. We will be tracking how these reports are used, in particular by parliamentarians.

In addition, the government has established an Independent Panel to advise on modernizing comptrollership in the federal government. This Panel will be looking at all aspects of comptrollership, including performance measurement and reporting.

We welcome the Auditor General's continuing attention to these matters. Updates on our progress will be provided annually in the President's Report to Parliament.

About the Audit

Objectives

The objectives of our audit were:

- to assess the government's progress in reporting departmental performance expectations and accomplishments to Parliament and central agencies through the Expenditure Management System; and
- to identify examples of good reporting of expectations and accomplishments to Parliament.

Scope

The audit focussed on performance information in the Expenditure Management System. We concentrated on performance expectations and actual performance in Performance Reports, Estimates Part III, Business Plans, the In-Year Update and Outlook documents of 16 pilot departments for the period 1995-96 and 1996-97. We also assessed performance expectations set out for 32 federal departments and agencies in the 1996 Annual Report to Parliament by the President of the Treasury Board. In particular, we assessed improvements made in the availability and nature of the information reported. We focussed on information about results, rather than financial performance per se.

We examined the role played by Treasury Board Secretariat in implementing related innovations to the Expenditure Management System, encouraging departments to report the expected and actual results of their activities and obtaining feedback and participation of members of Parliament. We also examined the use of performance information in the hearings of parliamentary standing committees.

Finally, we looked at the experience of other jurisdictions in reporting performance and in using accountability legislation to ensure the implementation and continuation of efforts to improve reporting for results.

Criteria

We assessed progress against two criteria. First, departments should report performance information that allows a judgment to be made on how well its programs are doing. More detailed expectations for good performance reporting are presented in Appendix B. We did not expect, at this time, to see all of these expectations reflected in all of the performance information being provided as part of the revised Expenditure Management System.

Second, Treasury Board Secretariat should have procedures in place to ensure a reasonable rate of progress in improving performance reporting within the Expenditure Management System. We expected to see

evidence of adequate guidance and direction, leadership, demonstrated commitment, supporting incentives, building of expertise in departments and support for learning and adapting.

Approach

We examined the relevant documents reporting on performance that form part of the Expenditure Management System. For all hearings on Outlook documents and Main Estimates documents for 1995 and 1996, we reviewed standing committee testimony and reports for references to departmental performance and looked for references to performance information in information requests made by standing committee members to parliamentary research staff.

Where appropriate, we relied on evaluations of the 1996 business planning process, the experience with pilot Estimates Part III and fall Performance Reports conducted by Treasury Board Secretariat staff.

We reviewed the literature on accountability legislation in other jurisdictions and interviewed officials from selected jurisdictions.

We conducted interviews with departmental and Treasury Board Secretariat officials and discussed improved reporting with a number of standing committee chairs. We also interviewed departmental officials and House of Commons staff with respect to the use of performance information by parliamentary standing committees.

We attended selected meetings of Treasury Board staff and departmental officials, participated in training sessions and observed several standing committee hearings.

Audit Team

Stan Divorski
Leslie Levita
Gerry Nera
Frances Smith
Shiv Sundaram
Glenn Wheeler
Tom Wileman

For information, please contact John Mayne, the responsible auditor.

Appendix A: Experience from Other Jurisdictions

Other jurisdictions report accomplishments

Other Canadian jurisdictions are reporting performance

Alberta published *Measuring Up: First Annual Report by the Government of Alberta* in June 1995. This report consisted of 22 “core measures” such as educational attainment, life expectancy at birth, family income distribution, taxation load, job creation, crime rate, and air/water quality. The 1996 version of *Measuring Up* compares actual results for the 1995-96 fiscal year with the goals or targets set in the government’s business plan. A summary of the government-wide results achieved was also reported in *Building a Strong Foundation - 1995-96, The Annual Report of the Government of Alberta*, published in June 1996. The annual reports of Alberta ministries and agencies for 1995-96 also include information on their performance achievements against targets and goals set in their individual business plans.

In April 1996, the Nova Scotia government published strategic goals in *Government by Design 1996-97: Building on Solid Ground*, the third such annual document. Tabled in the House of Assembly as a supplement to the Estimates, *Government by Design* is supported by and summarizes performance plans and priorities from departmental business plans. The document addresses four priority areas: economic renewal, redesigning government, social responsibility and fiscal stability. Similarly, in August 1996, the provincial government issued a progress report, *Financial Report 1995-1996: Hitting the Targets, Government by Design in Action*. In 1997 this document is expected to report actual performance against defined objectives. In addition, departmental reporting practices are being reviewed, and the intention is that annual reports will report performance on a more detailed level.

The Government of New Brunswick has published *Performance Measurement* on two occasions, as a supplement to the Main Estimates, for fiscal years 1996-97 and 1997-98. For the purposes of the 1997-98 document, departments were asked to identify goals, performance indicators, and targets for the majority of their core businesses. In their 1996-97 annual reports, departments will begin to report results for the indicators identified in *Performance Measurement 1996-97*. Subsequent reporting is intended to follow the same pattern.

Some of the other provinces are also moving to enhance their performance reporting.

Jurisdictions abroad are reporting performance

In the United Kingdom, executive agencies established since 1988 under the Next Steps Initiative - which now make up more than 71 percent of Home Civil Service -- publish Annual Performance Agreements and Annual Reports, respectively containing information on their expected and actual performance against specific targets. At the local government level, performance against a wide range of established performance indicators for municipal services such as police, fire control, social services, and libraries is published annually in a comparative format by the British Audit Commission, so that performance of local governments can be compared.

In the Australian federal government, program management and budgeting reforms in the mid-1980s led to the inclusion of performance information in Portfolio Budget Statements and in Annual Reports of departments and agencies. The former indicate the effect that budget measures will have on program objectives and outcomes; the latter “provide the information required for Parliament to make a fully informed judgment as to the effectiveness of the agency in meeting its program objectives.” Similar reporting practices exist in Australian state governments.

In the United States, several state governments are reporting on the performance of their programs and services against targets. For example, the Oregon government adopted measurable strategic goals in 1989, and published its third edition of *Oregon Benchmarks - Standards for Measuring State-wide Progress and Institutional Performance* in December 1994. Results achieved for state-level benchmarks, reported to the Oregon legislature, involve comparisons with targets, past achievement trends or national averages to assess progress made against state goals.

Texas launched an initiative in 1991 to adopt a unified and comprehensive system of strategic planning and budgeting, whereby performance information is made available to facilitate the biennial appropriation process. Minnesota published *Minnesota Milestones: A Report Card for the Future* in December 1992, outlining 20 broad goals and 79 measures with targets or “milestones” for future achievement. In a separate initiative, mandated by the State Legislature, state agencies issued their first performance report in September 1994 and are expected to report biennially.

The Government Performance and Results Act of 1993 (GPRA) requires U.S. federal departments and agencies to set strategic goals, measure performance, and report on the degree to which goals were met. The agencies are required to submit to the President and to appropriate authorization and appropriations committees of Congress an annual report on program performance for the previous fiscal

year. The GPRA requirements are being implemented progressively through pilots over a period of five years, with full-scale implementation beginning in fall 1997.

Accountability legislation in other jurisdictions

Accountability Legislation in the State of Western Australia

Western Australia enacted requirements for government agencies to report on performance in 1985, under the *Financial Administration and Audit Act*.

The framework consists of the Act, regulations made pursuant to the Act, and Treasurer's Instructions, which have the force of law. The Act establishes the role of chief executives of departments and agencies as "accountable officers", responsible for preparing and submitting annual reports to the Minister, which he or she then tables in Parliament. These annual reports are to include performance indicators and related information, in addition to financial statements and a report on operations.

The Treasurer's Instructions detail three types of performance indicators, which relate to key variables:

- workload indicators;
- efficiency indicators, which compare resources input against resulting outputs; and
- effectiveness indicators, which measure the extent to which programs achieve objectives.

Agencies are required to report key effectiveness and efficiency (not workload) indicators for each agency program.

The accountable officer is required to certify that the performance indicators are based on proper records and fairly represent the performance of the entity. The legislation requires the Auditor General to express an opinion on these performance indicators.

A royal commission appointed in 1992 found that the Act has "improved materially the information supplied to Parliament by way of annual reports."

Accountability Legislation in the Province of Alberta

Alberta's *Government Accountability Act* of May 1995 formally established requirements for the government and individual ministries to report performance information to the Legislative Assembly and to the public in plans and annual reports.

The Provincial Treasurer is to provide a consolidated business plan, indicating goals, the measures used to assess performance and desired results for "core businesses." For example, in 1996 there were three core businesses: people, prosperity and preservation, with a set of measures for each. Ministries are required to prepare business plans including the same type of information.

The Act also requires the Treasurer and ministers to provide consolidated annual reports comparing actual performance with desired results stated in their business plans. Although these provisions have not yet been proclaimed, pending further evolution of performance measurement reporting, both the consolidated and departmental annual reports are being prepared and tabled in the Legislature as if they were in force.

The legislation does not require an audit of non-financial performance information. However, the government has indicated its belief that performance measures must be audited to be truly useful.

Positive comments have come from several sources. For example, the Alberta Auditor General reported in 1996 that progress with government accountability is satisfactory.

As an advocate of the adoption of a legislative framework for the reporting of results, the Auditor General summarized the benefits of such a framework as follows:

- the legislation will foster and focus debate in the Legislative Assembly to improve accountability;

- an enduring system with a consistent format and a common vocabulary will assist users in understanding accountability information;
- the electorate will have the opportunity to suggest improvements through their representatives; and
- information will be comparable across organizations, and a means of ensuring compliance will be established.

Appendix B: Expectations for Good Performance Information

We believe that departments should report information on their performance that allows the reader to judge how well their programs are doing. To that end, we identified five characteristics of good performance reporting, which together allow a department to provide a credible account of performance:

Clear context and strategies. The report should clearly describe the mission and mandate of the organization, the objectives of its programs and services, the major strategies being used to achieve these objectives and the related external context.

There is a need to provide an overview of what the program is trying to accomplish under what operating environment and its relationship with broader organizational goals to allow for interpreting the performance reported. The *major strategies* being used, such as business lines, should be clearly described along with their sub-objectives. This should include information on all the major instruments such as loan guarantees and tax expenditures being used to achieve objectives, as well as both statutory and non-statutory voted expenditures. The related *external context* outlines the major factors, other government activities, risks and other influences outside the program that may affect the extent of progress toward the objectives pursued.

Meaningful performance expectations. The performance information should contain clear and concrete key performance expectations with a focus on outcome-results.

Clear performance expectations allow a reader to understand what result is intended. *Concrete* performance expectations can be qualitatively or quantitatively measured and hence be credibly reported as to whether or not they have been accomplished. *Key* expectations reflect the major intended results (usually outcome-oriented) expected from the program in relation to the interests and concerns of the users of the performance report. *Key* expectations also reflect the major or significant programs and elements thereof.

Performance accomplishments against expectations. The performance information should report key accomplishments in relation to expectations and be attributable to the activities undertaken.

Key accomplishments are those that the reader would expect to see reported in order to be able to judge the extent to which expectations have been met. This includes reporting of performance where expectations have not been met. Reporting of performance accomplishments needs to be selective to be useable.

Key performance accomplishments should be reported in relation to previously stated expectations, be linked to related mission statements and objectives and include the important aspects of the results achieved (outputs, intermediate outcomes, ultimate outcomes) and their costs, and related financial performance.

The performance information should be *attributable*. There should be a discussion and explanation of the extent to which the accomplishments achieved can be attributed to the activities of the program - how the program in question has made a difference.

Capacity to learn and adapt demonstrated. The performance information should provide a measure of the ability of the program to learn from past performance and to adapt to external changes.

A *capacity to learn* refers to the ability of the program to modify its strategies in light of past performance. In particular, where performance has been less than expected, the adjustments that will be made to reflect what has been learned should be reported. A *capacity to adapt* refers to the ability of the program to modify its strategies in light of the external context and in anticipation of future changes and challenges.

Fair and reliable performance information reported. Performance information should be fair, valid, reliable and understandable.

Fair information presents a balanced and timely picture of how well performance has been in relation to expectations, including cases where key expectations have not been met.

Reliable information can be validated. The reliability that can be placed on the performance information should be indicated in the report, by presenting such information as the method of data collection and verification, or whether the data are estimates or actuals.

Valid information is an accurate representation of what it purports to measure. It is essential that adequate explanatory and interpretive material is included in the report so that the reader can understand the relevance and importance of the measures provided and the context in which performance has been accomplished or not.

Understandable performance information allows the intended reader to see readily and clearly what results were expected and the extent to which they have been achieved.

Appendix C: Summaries of Evaluations of the Improved Reporting to Parliament Project

Evaluation of the Six Spring 1996 Pilot Part III Estimates

Treasury Board Secretariat, in response to a request of the Standing Committee on Procedure and House Affairs, undertook an evaluation of the revised Part III Estimates that six pilot departments tabled in March 1996 as part of the second phase of the Improved Reporting to Parliament Project (IRPP). The purpose of the evaluation was to determine the impact of the new approach.

The evaluation found that Treasury Board Secretariat and the pilot departments were moving in the right direction as they tried to better communicate what departments do and where they are heading. However, the evaluation showed that much remains to be done, particularly in measuring results and reporting on success. The following recommendations were made:

- Departmental teams working on these documents, in consultation with Treasury Board Secretariat, should share the lessons they have learned from this experience. Treasury Board Secretariat, in consultation with others, could prepare guidelines based on these lessons.
- Planning and performance information should be split into two separate, complementary documents so that departments may better focus on results.
- Treasury Board Secretariat should clearly define appropriate performance information requirements to foster a better understanding of the difference between outputs and outcomes.
- Treasury Board Secretariat should create model reports to give departments an illustration of appropriate content.
- Treasury Board Secretariat should establish a strong, consistent training initiative to help develop a better understanding of key concepts and their application to plans and reports.
- Treasury Board Secretariat should pick champion departmental prototypes, developed by task force teams, to give departments the opportunity for learning and demonstration.
- Treasury Board Secretariat should provide a framework of possible indicators, by type of program, to help departments select appropriate indicators for their own programs.

Treasury Board Secretariat management agreed with the findings and the recommendations.

Source: Evaluation Report: Improved Reporting to Parliament Project - A Report of the Parliamentary Working Group (June 1996)

Evaluation of the 16 Fall 1996 Performance Reports

Treasury Board Secretariat undertook an evaluation of the new Performance Reports prepared by the 16 pilot departments in response to a request from the Standing Committee on Procedure and House Affairs.

The evaluation examined whether the project maintained the broad support needed from stakeholders - parliamentarians (the primary audience), and departments (the suppliers of the information). The evaluation found some exemplary cases in which performance expectations were clear, measurable, targeted, and outcome-oriented. However, generally speaking the pilot Performance Reports did not present information that would fully allow readers to judge how well the departments are doing. Parliamentarians indicated that the objectivity of the performance reporting remains a concern. Overall, the key stakeholders were very supportive of the Performance Reports while recognizing that improvements are possible.

The evaluation made a number of recommendations similar to those in the evaluation of the revised Estimates Part III documents. Additional recommendations were that Treasury Board Secretariat should monitor the quality of departmental plans and Performance Reports, and that departments should include in their Performance Reports for 1997 how the views of the standing committee on their current report have been accommodated. Treasury Board Secretariat agreed with the recommendations.

Source: Evaluation Report: Improved Reporting to Parliament Project - Performance Reports; A Report of the Parliamentary Working Group (December 1996)

Chapter 6

Contracting Performance

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Contracting Performance

Assistant Auditor General: Shahid Minto

Responsible Auditor: Michael Weir

Main Points

6.1 In 1995-96 the government paid outside suppliers about \$14.3 billion (goods, services and construction), which included 6 million separate purchases affecting thousands of responsibility centre managers and suppliers, through 93 departments and agencies and 2,000 procurement experts.

6.2 Canada's treaty partners, businesses, appointed and elected officials and its citizens all define "good contracting performance" differently. The contracting process has become increasingly complex.

6.3 On the basis of our examination it appears that, while there is much to build on, there is a lot of room to improve the government's contracting performance. The conclusions we have reached are sufficiently serious, and the problems sufficiently widespread and long-standing, to warrant greater top-level attention to contracting than it has received in recent years.

6.4 Some aspects of performance have degraded over time, and others have remained below expectations for decades. Treasury Board has not established baselines despite the multiplicity of conflicting objectives.

6.5 Constraints to better contracting (and to more honest reporting about contracting performance) are complex, long-standing and deeply embedded. Because of the nature of the constraints, the variations among individual departments, and the changing environment of government contracting, the potential for improvement is not uniform among departments (and even within them) or across different categories of goods and services.

6.6 The Treasury Board and Public Works and Government Services Canada have put in place important elements of a framework to support greater departmental autonomy in contracting. Overall, however, much remains to be done to see that these objectives are understood, accepted and realized in practice.

6.7 To maintain effective overall control over increasingly delegated contracting activities, delegation needs to be supported by more effective functional direction and improved visibility for results and decisions. Treasury Board Secretariat needs to:

- explore better ways of managing long-standing tensions among the responsibilities, expectations and authority of individuals and organizations; and
- periodically provide Parliament with a better overall strategic assessment of contracting performance and priorities, showing the progress made toward agreed objectives.

6.8 Public Works and Government Services Canada can assist by providing functional advice and expertise to other departments. It also needs to ensure that contracting information provided to Treasury Board Secretariat and other stakeholders is timely, credible and free of material error.

Introduction

Government Contracting — An Overview

What is contracting?

6.9 A contract is an agreement or promise, enforceable by law. In this chapter, we are talking about agreements through which the government obtains goods and services from outside suppliers. We use the words “contracting”, “contracting activity” or “contracting processes” to describe the ways officials identify what they need to buy, set up agreements, and monitor and discharge contracts. And we use the words “contracting performance” to describe the many different results achieved in contracting.

Why does government contract?

6.10 Government buys goods and services as a way to get things done. The “business” of government has been described as “defining and attaining the goals of public policy.” Buying goods and services provides one way to obtain the inputs that officials need to “do business.” Sometimes it makes more sense to buy them from outside suppliers than to make or provide them directly.

What does government buy?

6.11 How much? The Public Accounts for 1995-96 show that the government paid outside suppliers about \$7.6 billion for services and \$6.7 billion for goods, for a total of \$14.3 billion, or just under one half of the government’s running costs. In constant dollars, this is about the same amount as it spent in 1983-84 (see Exhibit 6.1).

Exhibit 6.1

(This exhibit is not available, see the Report)

6.12 The government’s Contracting Activity Reports — which measure contracts at the time of signing rather than when paid — do not reflect very small or “informal” contracts. For 1994-95, the most recent data available, the Treasury Board reported that the government entered into formal contracts with a face value of about \$8.6 billion.

6.13 The government makes about 6 million separate purchases each year. Each purchase represents a “contract” between the government and a supplier. Most of these are small in individual value. Data from Public Works and Government Services Canada, for example, show that less than 0.2 percent of contracts account for about 90 percent of the total value it processes. Across the government, however, individually insignificant transactions can add up, and offer significant opportunities for smart buying. One department, for example, obtained 40 percent reductions on list prices for stationery and office supplies by offering all its requirements for competition.

6.14 **To obtain what?** The government buys many different kinds of goods and services. Goods range from ships to ballpoint pens; services range from janitorial services to health care. Public Works and Government Services Canada identifies the top 10 categories among the contracts it arranges as set out in Exhibit 6.2.

Exhibit 6.2

What Government Buys: Top Ten (in Dollar Value) Categories of Goods and Services

Top Ten Goods Categories	% of total \$	Top Service Categories	% of total \$
Data processing equipment	15.2	Business, management consulting and professional services	21.1
Communication equipment	7.4	Computer services, EDP consultants and computer repair and maintenance	7.7
Fuels, lubricants, oils and waxes	6.6	Aircraft repair and maintenance	6.4
Ammunition and explosives	4.3	Services for development assistance	6.3
Furniture	3.6	Engineering services, others	4.8
Aircraft and airframe components	3.5	Office building repairs and maintenance	3.7
Subsistence	2.9	Protection and security services	2.8
Vehicles	2.3	Hospital services	2.6
Instruments and laboratory equipment	2.3	Printing services	2.0
Electrical and electronic equipment	1.9	Temporary help (clerical) services	1.9
Other	50.0	Other	40.7
Total	100.0	Total	100.0

Source: Public Works and Government Services Canada

Risks in contracting

6.15 Contracting in general aims to meet operational needs and to secure the best value for the money spent. However, there are “many drains through which [contracting] dollars can disappear.” They can disappear if managers fail to sort out what they really want -- or if they make up their minds without shopping around. They can disappear if managers buy from unreliable or high-cost suppliers, if they order too much or too little, or if they accept less than was promised in the contract. In addition, those who contract must work within the framework of civil and criminal law. And there is always the risk that managers may make contracting decisions for their own advantage, or that of friends or associates. All of these considerations apply to contracting in both the private and the public sectors.

6.16 Public sector contracting must balance additional risks and aims. It is expected to contribute to a range of public policy objectives that are “secondary” to direct operational needs, but important to stakeholders. It must, as a matter of law, conform to complex legal obligations. And it must deal appropriately with pressures to influence contracting for electoral or partisan advantage or for special-interest considerations, including those of suppliers. Contracting activity takes place under the conventions of ministerial responsibility: a minister may be called upon to explain and defend any transaction entered into under his or her authority. As the Treasury Board cautions, each transaction must be able to withstand the test of public scrutiny. Government contracting must cope with these additional expectations without being able to use some of the more aggressive — or co-operative — contracting tactics ascribed to some private sector organizations, and without incurring excessive administration costs.

6.17 The introduction of alternative service delivery highlights the importance to the government of better contracting, in two ways. First, studies of some privatized operations suggest that better contracting was one of the main routes through which they achieved lower costs. A government that wants to work better and cost less thus needs to care about its contracting performance. Second, delivery of services through contracts introduces different kinds of risks for the government to manage.

Significant influences on contracting

6.18 The current environment poses many challenges for elected and appointed officials responsible for directing and improving contracting performance; for legislators who wish to provide informed, constructive oversight; and for auditors who serve the accountability relationship between them. Some of the more important are described here.

6.19 Mixed expectations. Canada's treaty partners, businesses, appointed and elected officials and its citizens all expect different results from government contracting. They all define "performance" differently. To the basic expectations (meet operational requirements and get best value) can be added those of a range of public policy advocates, interest groups and stakeholders.

6.20 Legal obligations. Federal contracting for goods and services, like all contracting in Canada, is subject to the provisions of the common law (or civil code in Quebec), to some 15 specific Acts of Parliament and to various treaty obligations. These establish the legal framework within which appointed and elected officials can properly exercise discretion. Among the more important treaty obligations are:

- the Agreement on Internal Trade;
- the World Trade Organization Agreement on Government Procurement;
- comprehensive land claims agreements; and
- the North American Free Trade Agreement.

6.21 In broad terms, the effects of legal and treaty obligations have been to restrict the extent to which the government can act arbitrarily in awarding and administering contracts. They have established redress mechanisms for individual suppliers. To a limited degree, these extend the existing enforceable rights of suppliers — to fair treatment in the administration of contracts — into the contract award process. At the same time, treaty obligations have restricted the extent to which the government can direct contracts for socio-economic (especially regional development) reasons, while land claims agreements have created obligations to promote Aboriginal development through contracting.

6.22 Information technology. Increasingly, the advent of technology has changed how and what the government buys. The government spends about \$2 billion per year for goods and services in the areas of information and communications; using traditional approval and contracting processes to contract for technology hardware and services can cause problems down the road that cannot be specifically anticipated in advance.

6.23 Technology has also changed the way the government contracts, and will likely continue to do so. More information moves faster, and can be correlated differently, opening up possibilities for using information in different ways, and changing the nature of the information decision makers want. It has made possible such innovations as "just-in-time" procurement, and has revolutionized materiel management. Such arrangements change the way the government and its suppliers relate to one another.

6.24 Administrative reform. Like all aspects of government operations, contracting is affected by the ongoing changes in the management of the public service. This has been characterized by the Treasury Board as the pursuit of a "fact-based, results-oriented, open and accountable" public service. In the process, the public service culture is being changed. Assumptions of continuity, employment security, homogeneity and anonymity that formed part of the traditional public service employment "contract" are being replaced with a growing realization of the permanence of change. This is evident in the greater mobility of professional managers both among departments and between government and business, in a more diverse public service, and in higher visibility of appointed

officials. Without commenting on their merits, we note that these changes have affected the control environment in which contracting takes place. They have changed the basic assumptions on which the government traditionally based its approach to managing the risks inherent in contracting.

6.25 Further, continued delegation of contracting authority to departments places individual ministers and their deputies in a position where they are responsible for making finer judgments than before about contracting activity and performance. Not all departments are alike. This introduces the need for flexibility in approaches. It also introduces a need for tools that help managers maintain a balance between allowing contracting performance to divert attention from their primary responsibilities on the one hand and, on the other, taking it for granted to the extent that it fails the test of public scrutiny.

6.26 Performance pressures. The growing recognition of the deficit has put pressure on the government to reduce its size and cost, and to demonstrate better results for money spent. This emphasis on “results” in government creates a number of challenges.

6.27 One challenge has been to balance the desire for good results with concern for due process and legal obligations. Faced with a choice between observing the contracting rules or meeting a significant operational deadline, most line managers we talked to would at least bend the rules. Sometimes they cross the line, and get caught (see Exhibit 6.3).

Exhibit 6.3

Competing Priorities

Officials received two bids to fill a requirement for emergency power equipment. One was for \$25 million; the other, for \$10 million, did not meet the specifications demanded. Officials did not have the contract rebid but allowed the low bidder to modify its proposal and then awarded it the contract. The losing bidder appealed; the Canadian International Trade Tribunal upheld the complaint and recommended compensation for costs and loss of profits amounting to about \$2 million.

6.28 Another challenge is to discern whether results are getting better or worse, and to decide whether reported instances of poor results represent a pattern that calls for high-level action across the board, or individual deviations that are best dealt with at the local level.

6.29 Overall management context. Decisions and choices about individual contracts always take place within the context of broader management decisions, and particularly budget allocations. A manager with contract dollars in his or her budget, but without authority to hire staff, does not have a realistic choice between contracting and hiring. Past decisions and resource allocation patterns influence current contracting decisions and choices. These are set before “contracting activity” begins, and adjusted through mechanisms such as budgets, business plans and operational plans. Financial management considerations have been shown to significantly concentrate contracting activity in the last quarter of the year, for example, restricting ability to obtain best value.

6.30 Market considerations. The nature, size and structure of the pool of suppliers from whom the government buys its goods and services affects government contracting. It is difficult, for example, to get effective competition in markets characterized by a small number of dominant suppliers and with little excess capacity. At the same time, there are 99 losers and just one winner when a tender attracts 100 bids. The government has choices about how and into which marketplaces it feeds its demands; these choices have impacts.

Responsibility for Contracting Performance

6.31 Responsibility is shared within the government for responding to these influences, and for meeting the many, mixed expectations of different stakeholders. Government procurement experts, line and financial managers and suppliers share responsibility for meeting the expectations, day by day and contract by contract. The Treasury

Board, pursuant to sections 7 and 41 of the *Financial Administration Act*, provides leadership and a policy framework on behalf of all ministers. Public Works and Government Services Canada has operational responsibilities. Parliament has given it exclusive authority to acquire goods, and a responsibility to plan and organize the supply of goods and services. As a common service agency, it fashions many of the tools officials and suppliers use. It also holds much of the information and expertise necessary to support the Treasury Board Secretariat and departments. As more authority is delegated to line departments, they share increasingly in the responsibility.

6.32 Parliament, particularly through its Standing Committee on Government Operations, has held many hearings to consider and recommend changes to government contracting practices. In doing so, it has explored the practical implications of establishing oversight and accountability for government contracting, and has signalled the importance parliamentarians attach to contracting.

Focus of the Audit

6.33 We undertook this audit to inform Parliament about the government's contracting performance. The question we addressed was not whether the government sometimes contracts well or poorly; we focussed on the general direction of government contracting. We wanted to see if the instances of poor results as reported from time to time in our audits, internal audits and the media are endemic and worsening — deserving top-level attention — or whether they mostly represent isolated instances of deviation from prevailing norms and standards. We examined both the accountability framework established by the Treasury Board and the results obtained by those following its leadership and working within its framework. Exhibit 6.4 summarizes the key criteria we considered important to achieving management and operational results that characterize good contracting performance.

Exhibit 6.4

Contracting Performance: Key Criteria for Results

Management Results

MANAGEMENT DIRECTION: The extent to which the contracting objectives of the government are clear, well understood and well integrated into the government's plans, structures, delegations of authority and decision making.

MONITORING AND REPORTING: The extent to which contracting performance is monitored, reported and acted upon.

PEOPLE AND WORKING ENVIRONMENT: The extent to which the government provides appropriate incentives, sanctions and development opportunities to sustain a skilled and competent contracting work force.

OTHER RESOURCES AND TOOLS: The extent to which contracting processes and tools provided are appropriate to achieve the desired contracting performance.

Operational Results

SCREENING: The extent to which contracting screens out requests for goods and services that are unacceptable, unduly expensive, or unnecessary, so that it buys -- with integrity -- only what it needs.

COMPETITION: The extent to which competition (when used) is open, fair and gets good value.

DELIVERY: The extent to which government contracting delivers what was agreed, when it was agreed, and for the price agreed.

CYCLE TIME: The extent to which the government arranges contracts in a timely manner.

ADMINISTRATIVE COSTS: The extent to which the federal government arranges and administers contracts at a reasonable cost to all participants.

CONTRIBUTION TO OTHER OBJECTIVES: The extent to which contracting contributes to -- or does not undermine -- other objectives.

6.34 We based our judgments on Treasury Board policy, augmented where necessary by reasonable expectations. Against these expectations, we considered a range of information derived from government databases, management reports, testimony before standing committees, past audits, interviews and examination of individual contracts.

6.35 Illustrative cases that support our findings are presented in the special insert beginning on page 6–14.

6.36 Further details of the way we carried out the audit can be found at the end of the chapter, in **About the Audit**. A report based upon a technical review of the contracting process against our audit criteria has been provided to the Treasury Board Secretariat.

Observations

Overall, Contracting Needs More High–level Attention

6.37 On the basis of our examination it appears that, while there is much to build on, there is a lot of room to improve the government’s contracting performance. The conclusions we have reached are sufficiently serious, and the problems sufficiently widespread and long–standing, to warrant greater top–level attention to contracting than it has received in recent years.

6.38 The evidence we have seen shows that some aspects of performance have deteriorated over time, and comparison with past studies and royal commissions suggests that others have remained stubbornly below expectations for decades. The Treasury Board Secretariat has not established baselines or clear expectations, and there is insufficient relevant and credible information about the results achieved against some important criteria to support a firm conclusion about whether those results are getting better or worse, or, indeed, if many of the desired objectives are being met. The potential for improvement is not uniform among departments (and even within them) or across different categories of goods and services.

6.39 With respect to policy and framework responsibilities, Treasury Board Secretariat (TBS) and Public Works and Government Services Canada (PWGSC) have acted to:

- make departments more responsible for contracting;
- implement treaty obligations; and
- adapt to the impact of technology.

They have put in place important elements of a framework for greater departmental autonomy in contracting. Overall, however, much remains to be done to see that these objectives are understood, accepted and realized in practice. Right now, the lack of agreed–upon goals and priorities suggests an acceptance of only incremental change, which is at odds with the challenges facing government contracting.

6.40 Significant investments in processing and information systems have been made, and now need to produce the intended operating efficiencies. The information generated by systems, and by the government’s review capacity, is just beginning to be channelled to help the Treasury Board Secretariat guide contracting performance; to

identify the present level of contracting performance (or capacity); to agree on clear targets for improvement; and to see that targets are met.

6.41 Government/industry consultations, and our interviews, reveal widespread concerns that the government has lost or is close to losing the critical skills needed to contract well. But we found no one responsible to see that the government has, or is developing, the skills needed to maintain or improve contracting performance. Contracting performance will be critical to the government's strategy for alternative service delivery.

6.42 The operational results we observed vary among departments and with different types of goods and services. We believe that the government still derives substantial benefits from the legacy of public service values and the basic integrity of the established processes, particularly in contracting for traditional goods. Too rarely, however, is contracting performance guided by clear, concrete and challenging performance goals and expectations.

6.43 Particularly in contracting for information technology and related professional services, results have been disappointing. Screening requests for systems development contracts presents special challenges, and we agree with the Treasury Board Secretariat that the need for improvement has become critical.

6.44 It takes time for efforts to show up in results. This report would be unbalanced if it did not recognize the scope and scale of current efforts to provide stronger leadership and a more flexible but more clearly defined framework. We observed initiatives at the centre and in departments as well as at the individual level. They include, for example:

- the recent report of a deputy minister task force on the management of common services;
- re-engineering initiatives in departments; and
- changing buying patterns to realize potential economies of scale.

ILLUSTRATIVE CONTRACTING CASES

During the course of this audit, we interviewed the staff involved with, and examined the files pertaining to, about 60 of the contracts included in our survey. The following cases illustrate many of the issues discussed in this chapter

These case histories are not presented as representing anything but themselves; they are illustrative rather than representative. We expected that there would be good and not so good contracts. Some of both are described here, and internal audit reports detail many more. Readers should not draw inferences about any department or the government as a whole based solely on these cases.

If there are common messages we can draw from these cases, they are these:

- there is a big difference between compliance with rules and "good" performance;
- many of the decisions that shape contracting performance are made before the individual contract requisition is raised. The results achieved by officials who actually initiate, process and approve individual contract requests reflect the influence of broader management and comptrollership decisions; and
- once poor or marginal contracting practices take root they are difficult to change, and it becomes difficult to manage performance.

Case 1 Contracting for Software

This case illustrates how good screening - in deciding to aggregate small requirements - got better value for the Crown. It also illustrates how the perseverance of one individual can make a difference by changing established patterns. This is but one example of a good screening practice. Similar efforts are being introduced in other departments.

The department's Informatics Directorate reviews all requirements for software to ensure compatibility with existing software and programs. During 1994 the Informatics Director noted that numerous requests for a common software were being made. He issued instructions to hold and consolidate these requests and see whether a bulk buy might result in a better price than that available from a pre-existing standing offer agreement. Requisitions were accumulated over a period of two months that, according to the department, would have cost approximately \$3 million at the standing offer price. The department persuaded Public Works and Government Services Canada to negotiate a price of \$1.3 million, which covered all present and future departmental requirements, under a site-licence agreement.

This contract, sole-sourced because of copyrights/exclusive rights, was successfully negotiated to secure a better price. The department estimates that it saved nearly \$2 million. While grouping the requirement did increase cycle time and added costs, the savings more than offset any additional time and cost required to consolidate requests and negotiate prices. Public Works and Government Services Canada officials interviewed in connection with this case noted that this is the direction in which they want to go.

Case 2 Contracting for System Services

This series of contracts, issued over a six-year period, illustrates a number of points discussed in the chapter. Among the more important:

- *Competition in form alone doesn't necessarily achieve "best value", and there are risks associated with initiatives taken based on a single indicator without an understanding of the context and related impacts.*
- *In balancing operational demands and contracting considerations, managers do what is possible, taking shortcuts if necessary, and strive to improve contracting performance over time.*

In 1993-94, after a number of years of intense development activity associated with government-mandated systems development, over 600 IT contractors were working in the department to respond to its needs for IT professional services. The value of the contracts associated with these contractors was approximately \$71 million. A factor contributing to this level of contracting was that until 1 April 1993, person-year controls were in effect on a government-wide basis. In some cases, departments had been provided with the dollars to make the required systems changes but no authority to hire staff. The department established the contracts under PWGSC's Supply Arrangement for Informatics Professionals and reported them, according to appropriate definitions at the time, as non-competitive.

The department told us that in 1994-95 it issued a letter of interest (LOI) to all firms appearing on PWGSC's Supply Arrangement for Informatics Professionals. The purpose of the LOI was to establish a source list of suppliers qualified to supply the department's specific IT services needs. The department consulted closely and held all vendor briefings with vendors on the LOI approach. The department also indicated that it consulted an association representing a significant portion of the Ottawa vendor community. The department received approximately 110 responses representing some 2,100 different contract resources.

Approximately \$38 million of IT professional services contracts were issued to 327 contractors by tendering from a source list. Of these, 295 had been awarded contracts under the previous arrangement. Although the rules were followed, and the *form* of competition was observed, there was little effect on who got the business despite the added costs to the government and suppliers.

On reviewing a sample of the 1994-95 contract files, however, we noted other factors - which go to the *substance* of competition - that may have played a part in the openness and fairness of the bid solicitation and evaluation processes.

In 1995-96, the department amended many of the contracts established under the Letters of Interest (LOI) in 1994-95 to add an additional year of service. These amendments qualified as competitive under the definitions provided by the Treasury Board at that time.

In 1996-97, the department used the Informatics Professional Services System of PWGSC to source most of its requirements.

The department also notes that by late 1996-97, turnover among contractors had significantly increased. Indeed, of the contractors on site at the time, approximately 40 percent represented "new" contractors who had not previously been under contract with the department.

Management attributes the low contractor turnover in 1994-95 (approximately 10 percent) to the need for system-specific experience and skills for its departmental systems and to the limited qualified external resource pool from which to draw. It also notes that while the “renewal” ratio for previous contractors appears quite high, it is not unreasonable given the aforementioned need to balance the implementation of changes in contractor participation with the requirement to develop and operate systems central to the operations of the department.

As at 1996-97, the department believed that it had made significant progress in regard to the use of IT contractors:

- The number of contractors was reduced to as low as 155 (25 percent of earlier numbers) in the summer of 1996, though this number fluctuates with total resource requirements and availability of staff.
- Dependency on contractors in the support of specific systems has been significantly reduced, and core knowledge and expertise for all systems is now vested in government employees.
- Contracting strategies for contracting of IT professionals continue to be improved.

Case 3 Protective Equipment

This case illustrates how poor screening - involving inadequate testing - led to operational deficiencies and had a major impact on value for money.

(This case came to our attention through a review of departmental internal audit reports.)

In 1984, the department decided to develop and design a type of protective equipment. The design was to be based on that of another country, but incorporating Canadian modifications. In September 1986, field trials were carried out on a prototype design. Based on this testing, final specifications were issued and a \$10.5 million contract was awarded to produce the equipment. The item was delivered in February 1991.

Subsequently, certain design flaws affecting the performance of the equipment under field conditions were noted. The department states that the operational deficiencies were largely attributable to project management issues. There was insufficient follow-up of user trials during product development. There was also acceptance of a significant change to production specifications without a formal evaluation to determine the overall effect on the end product. Should the department decide to modify the equipment, the additional cost could be up to \$4.5 million. If the modifications are not carried out, the equipment will be very limited in its use.

In response to an internal audit review of this case, the department is committed to applying the lessons learned from this project to ongoing projects.

Case 4 Production of Products Using Intellectual Property

This case illustrates the difficulties of contracting fairly for goods or services involving intellectual property developed by the Crown.

In 1993 the department granted a company sole right and licence to market and sub-license products and product updates worldwide and to use departmental data to create these products and product updates. Initially this licence was issued for five years with an additional five-year option, at the discretion of the licensee (the agreement was subsequently amended to make the option exercisable at the discretion of the Minister). Quality control remained with the department. The department did not prepare, prior to granting exclusive licence, a business case or other analysis that identified the value of the data being made available or the need for products contemplated under the agreement.

In 1995 the department issued a sole-source contract, with a total value of over \$250,000, to the same company to supply products based on the data. The sole-source rationale was justified with reference to “exclusive rights”, based on the department’s licensing agreement. The department had, by its previous decision to award exclusive rights, effectively eliminated other suppliers from competing who could

have processed and packaged the data. By failing to perform appropriate analysis prior to granting the exclusive rights and licence, this department has forgone the benefit of competitive tendering.

The Department is in the process of contracting an individual to perform a general review of the agreement, with a view to determining if this is a good agreement for the government. Depending on the outcome, changes to the agreement may be warranted.

Case 5 Information Technology Services Contract

This case illustrates how lack of clarity about what is really needed can lead to poor “screening” decisions - with downstream effects on, for example, the fairness of competition, delivery, and maintenance of the merit principle.

Over a five-year period, the department contracted with a company to provide software development, maintenance and support services for in-house computer systems at a cost of about \$500,000. The department informs us that the services being provided relate to a very important program for which service is very difficult to obtain, because of the age of the programs being used. Over 90 percent of the services were provided by the same individual over this period, notwithstanding that the original contractor assigned its interests in the contract to another company. We have not been provided with any documentation to demonstrate that the expenditure of approximately \$100,000 per annum was the most economical way of meeting the requirement.

Two factors undermine the perceived fairness of the competition by which the contract was awarded. First, terms and conditions that were deemed essential - and were used to disqualify some bidders - were relaxed for the substitute candidate provided by the winning bidder before work started. Second, the bid evaluation process and criteria poorly reflected the actual requirements of the work that had to be done, as shown by subsequent usage. Had the bid evaluation process and criteria reflected actual requirements, a different bidder would have scored higher, at a price some 20 percent lower than that accepted.

Case 6 Consulting Services

This case illustrates the difficulties of controlling expenditure when entering into flexible relationships with consultants for advice without clearly specifying the deliverables.

In 1994, the department entered into a standing offer arrangement that provided for support and consultation on a per diem basis. This contract was valued at \$200,000, which was to cover advice and consultation over a period of 16 months. Within eight months, 85 percent of the funds had been expended. The department terminated use of the standing offer arrangement and negotiated an eight-month, fixed-price contract - to cover a very small subset of the previous services - for the balance of the period. The value of this new contract was equivalent to the leftover funds. A different contractor was engaged to perform another aspect of the requirement that, according to departmental officials, would be better provided centrally.

The department did limit its cost liability, and reduced its per-month costs by adopting a fixed-price format for the extension and by scoping out certain aspects of the deliverable. However, it is our opinion that even the revised contract terms were too vague to provide effective guidance to the contractor, or control over his invoices.

Contracting Results Remain below Expectations

Management direction — framework and expected performance need clarification

6.45 The overall objectives of government contracting — to meet operational needs and to secure best value — are generally clear, in our opinion. Many of the mechanisms for integrating these objectives into plans and structures have been put in place or provided for, and practices have begun to change.

6.46 However, we believe there is a reasonable case for more purposeful improvement of contracting results. A number of useful analyses have been carried out, but not since the Nielsen Task Force Report of 1985 have we been able to find any clear attempt to assess the possible payoff from buying smarter, and what it would take to obtain it.

6.47 The leadership of TBS and PWGSC has not always been clear or co-ordinated. They are not yet in a position to demonstrate that they have successfully created the conditions to promote both good results and respect for rules. Who is responsible for what is too often unclear, and performance expectations are vague and conflicting.

6.48 Confusion about the respective roles and responsibilities of PWGSC, Treasury Board Secretariat and line departments has persisted for decades. On the one hand, PWGSC's legislation states, for example, that it has a responsibility to improve the efficiency of the whole contracting process. Its officials note that the common service role may well be seen to deny program managers authority to manage. At the same time, PWGSC is clearly expected -- in, for example, decisions of the Canadian International Trade Tribunal -- to play a control role, screening requisitions to ensure that specifications are open and fair and making sure that the process followed complies with laws. On the other hand, Treasury Board Secretariat officials acknowledge that PWGSC has statutory authority to purchase goods and enter into service contracts if asked to do so by client departments. PWGSC's contracting activities are expected to function within the policies and guidelines issued by Treasury Board, just like any other department.

6.49 Our own observations, internal audits and documents all suggest that this confusion over service or control finds its way to the individual procurement officer, and to the line manager who receives mixed messages about whether and how far to push suggestions for better contracting practices. Internal audit reports observe time and time again that line managers and procurement officials do not understand well their responsibilities or how to work effectively together to achieve good results. Within departments, our observations confirm this assessment, while suggesting that some departments have set clearer direction than others.

6.50 A Treasury Board synthesis of internal audit reports dealing with contracting over the last five years comments on the extent of understanding:

Time and time again, managers reported that they and their staff either did not know something contravened contracting policy, did not understand the significance of a requirement, or did not see how it applied in their particular situation.

... the most common thread running through the reviews was the lack of clear communication about the meaning, content and importance of central agency and/or departmental policy requirements to those who most needed to understand them.

6.51 Within Public Works and Government Services Canada — and between it, the Treasury Board Secretariat and departments — there are significant unresolved debates about the scope of organizational responsibilities and how best to discharge them. In the absence of a clearer sense of direction, and better linkages to responsibilities and reporting, the ongoing discussions and debate about the authority of Public Works and Government Services and individual departments lack focus, and we are unable to assess whether the authority delegated is commensurate with the responsibility assigned and the performance expected.

Monitoring and reporting — credible and relevant information still lacking

6.52 Over the past few years the government has made efforts to improve its monitoring and measurement capacity. We observed encouraging uses of information. For example, the Treasury Board Secretariat has begun to provide feedback to departments based on their contracting statistics. It recently analyzed internal audit reports dealing with contracting to draw out common patterns and themes. The Standing Committee on Government

Operations has held a series of hearings on contracting that have elicited external perceptions, exposed inaccuracies in existing data and, most significant, signalled the importance that Parliament places on contracting.

6.53 Overall, however, current reporting practices do not yet provide the kind of credible and relevant information needed to manage. Quantitative data about government contracting are fragmented, replete with jargon, and laced with inconsistencies. Some of the problems include inconsistent definitions of indicators, unreconciled data, and insufficient attention by senior management.

6.54 Inconsistent indicators. The two main indicators of contracting activity that the Treasury Board Secretariat monitors are the ratio of competitive to non-competitive contracts and amendments. There are problems with both of them.

- **Competitive and non-competitive contracts.** Treasury Board policy defines a sole-source contract as competitive if public notice has been given of the intent to award it and that notice has not been validly challenged by another bidder. For treaty reporting purposes, however, such contracts are classified as non-competitive. Some standing offers and supply arrangements are issued as a result of a competitive process. Call-ups against such arrangements are sometimes considered competitive and sometimes non-competitive. A departmental official writes: "It is suggested that [Public Works and Government Services Canada and Treasury Board Secretariat] work with departments to resolve the above questions in order to arrive at a consistent and fair representation of departmental procurement practices." The problems are compounded by the number of contracts that attract only one bid but are nonetheless classed as competitive.

- **Amendment data.** Not all amendments are bad. But the systems do not distinguish between, for example, extensions that were clearly contemplated -- and disclosed -- when the contract was tendered, those that arose because of unforeseeable circumstances, and those that arose because of poor estimation or specification.

6.55 Insufficient senior management attention. Hearings of the Standing Committee on Government Operations raised the profile of contracting performance, causing departmental officials to look more closely than before at their contracting results. Officials in one department told us that it took four person-months of work to make sense of the contracting activity figures reported for them, and to prepare for the hearing. Officials in Public Works and Government Services Canada acknowledge the problems in government contracting data but do not believe they have the mandate to fix them.

6.56 As mentioned previously, many of the mechanisms to support more purposeful procurement exist but as yet the market and purchasing information that would support those mechanisms has not been harnessed.

6.57 The Treasury Board Secretariat and Public Works and Government Services Canada have yet to:

- develop a consistent and balanced reporting framework that would adequately support the trend to delegate more "contracting authority" without compromising effective control;
- find appropriate means to get managers to interpret raw data and indicators;
- resolve ongoing arguments about how to define and categorize common indicators and data elements that would support an agreed-upon framework, and permit effective sharing and aggregation of data; and
- process contracting faster, audit it more consistently, and share it more effectively.

People and working environment — concern about loss of contracting knowledge

6.58 Regarding incentives and sanctions in contracting performance, Treasury Board has set the tone at the top by commending some departments and exhorting others to do better, based on their Contracting Activity Reports. As yet, the weaknesses described elsewhere in the reporting of information make it difficult to reliably recognize good and bad performance as a basis for providing appropriate incentives, sanctions and training.

6.59 Pinpointing the difference that people make. At the level of individuals, we were advised of two instances where contracting authority had been rescinded or withdrawn in seven departments over the last five years. Contracting and finance officials knew that some responsibility centre managers consistently discharged their contracting responsibilities better than others. But, with one exception, we found no organized efforts to establish the patterns and to focus training or remedial action where it could do most good. Some managers with whom we discussed this pattern cautioned that informal peer pressures, while not visible, play an important role in creating the work environment. Others, however, observed that without greater visibility there would be no real accountability, and no incentive to disturb the status quo.

6.60 There are widespread concerns about the loss of skills, corporate memory and knowledge (as there are in other parts of the government), and about the need for greater skills to carry through still further delegation of contracting authority and respond to changing patterns. There is a particular lack of detailed knowledge about products and markets. Based on the operational results, the explanations given for deviations, and staff surveys, the evidence suggests considerable support for these concerns. For example, while there has been a 10 percent increase in the number of Procurement Grade Officers over the last 10 years (see Exhibit 6.5), we found no one with clear responsibility for assessing ongoing skills and capacity requirements.

Exhibit 6.5

(This exhibit is not available, see the Report)

Other resources and tools — progress is being made

6.61 The Treasury Board Secretariat, individual departments and Public Works and Government Services Canada have made progress toward developing the tools to implement the requirements of trade agreements and to automate contracting. The evidence suggests that a significant portion of the potential returns from this investment remain to be realized.

6.62 Sharpening the tools. Public Works and Government Services Canada aims to improve its Open Bidding and its Automated Buyer Environment systems to support the government's strategy of increased delegation to departments, and to focus its own efforts on high-risk procurements. In December 1996, it completed an evaluation of its open bidding policy and system. The report concluded that while information technology had been introduced, significant "teething" troubles and implementation concerns needed to be addressed. These include:

- reducing system and process costs for the government as well as suppliers;
- better categorizing information and opportunities in the system; and
- linking the advertising system with the processing systems.

The evaluation also reflected a number of unresolved questions about broader management direction that need to be addressed before adopting open bidding for all contracts over \$25,000, to the exclusion of pre-qualifying bidders through source lists and other means.

6.63 Other initiatives respond to specific marketplace pressures and to performance problems in complex systems development contracts. The government is not yet in a position to report success in developing the tools to contract well for service delivery, or in developing (or buying) the tools to support smart buying of specific types of goods or services. We are unable to conclude whether the costs involved have been reasonable, because we do not know how much the government has spent. As for other aspects of support costs, the information is fragmented and incompletely recorded. The systems development costs alone, however, significantly exceed \$300 million. A recent deputy minister task force questioned the affordability of continuing to develop systems in an unco-ordinated manner, and recommended consolidation of the effort.

Screening — practices need significant improvement

6.64 The Treasury Board sets high expectations for the screening of requests for contracts. Both Treasury Board and line managers rely heavily on business planning and budgeting processes to separate “wants” from “needs”, and on review and approval processes to frame requirements so as to obtain best value and respect government contracting rules. We did not examine program management or comptrollership in individual departments and are unable, therefore, to conclude definitively whether or not only valid operational needs are contracted for. However, evidence such as the high level of inventories held (discussed in Chapter 23 of our 1996 Report) and overall expenditure patterns suggests that these mechanisms have had limited success in challenging historical contracting patterns.

6.65 Screening practices for individual contract requests do stimulate competition or negotiation of better value from suppliers, and detect and deter some inappropriate requests. Line and functional managers stressed that their day-to-day interactions, contacts and involvement provide them with important information about contracting activities and performance. Many of them provided anecdotal evidence of having changed or stopped proposed contracts before formal requisitions were issued. They also typically noted that about 80 percent of problematic contract requests emanated from 10 to 20 percent of managers. For the most part, they prefer to deal with such managers informally. One line department and one central agency provided anecdotal evidence of having restricted or withdrawn contracting authority or required refresher training as a result of informal monitoring.

6.66 However, our current work suggests that results would have to be improved significantly to meet or even approach the expectations of the Treasury Board. Not enough contracts are competed for to meet Treasury Board or public expectations. Despite sustained pressure to improve the extent of competition, annual Contracting Activity Reports for the four years 1991-92 to 1994-95 (see Exhibit 6.6) show the levels of open or selective tendering, which according to the government have stayed below expectations.

Exhibit 6.6

Competition Tables

Categories	1991-92		1992-93		1993-94		1994-95	
	\$ Billions							
Competed (Openly, or Selectively) ¹	5.6	66.4%	4.6	53.9%	4.9	63.7%	4.3	56.5%
Sole Sourced with notice ACANS ²	0	0	0	0	0	0	.3	3.8%
Total	5.6	66.4%	4.6	53.9%	4.9	63.7%	4.6	60.3%

	Thousands of Contracts							
Competed (Openly, or Selectively) ¹	77.2	86.4%	15.1	63.7%	17.5	62.7%	16.3	60.6%
Sole Sourced with notice ACANS ²							1.5	5.5%
Total	77.2	86.4%	15.1	63.7%	17.5	62.7%	17.8	66.1%

Extent of competition for contracts over \$30,000³

- 1 About 10% of the number of contracts and 10% of the value of competitive contracts processed by Public Works and Government Services Canada had only one bid. Neither Public Works and Government Services Canada nor departments capture information that would allow us to determine what percentage of costs receive more than one bid but only one bid was compliant.
- 2 ACAN = Advance Contract Award Notice - notification that one supplier will be awarded a sole-source contract, unless others show they can also provide the goods or service
- 3 1994-95 < \$25,000.

Source: Treasury Board Secretariat, Annual Contracting Activity Report, reclassified

6.67 When competition is not practical, more could be done to negotiate best value. Where only one supplier is invited to bid, or use is made of standing offer arrangements, prices are sometimes negotiated. Our sample indicated that this applies to 40 percent of sole-sourced contracts, and to 29 percent of those called up under standing offers. There is some confusion about whether and under what conditions it is appropriate to negotiate the price under a standing offer arrangement.

6.68 Despite the number of approvals required in policy, screening practices appear to have had limited success in clarifying just what is required, particularly in informatics and service contracts. The evidence suggests that some departments specify what they require more clearly than others.

Competition — expectations are vague

6.69 Treasury Board describes competition as the cornerstone of government procurement. Effective competition seeks out best value for money, and minimizes the risk that officials may make contracting decisions for their own advantage or that of friends and associates.

6.70 The evidence suggests that competition, where it is used effectively, does produce better prices and other benefits. Open bidding, where it has been used, has attracted more bidders for individual contracts. Advance notice mechanisms have made it more transparent and independent appeal processes have made it more fair. The 1996 evaluation of open bidding reports that, on average, Public Works and Government Services Canada sent out more bid sets and received more bids for openly advertised opportunities than for those selectively advertised. In 1994-95 it secured, on average, about 10 bids for each openly advertised opportunity compared with about 6 bids for selectively advertised opportunities.

6.71 At the same time, few benefits are achieved when the forms of competition fail to attract more than one supplier. Internal audit at PWGSC reported that open bidding had only limited success in opening up government business to new suppliers. Rather, the same suppliers were competing harder for the business advertised through the open bidding system.

6.72 Most contracts are not advertised on the open bidding system. They are awarded through selective tendering or are sole-sourced. Representations from small business, and internal audits, both suggest that these contracts are not open because their complexity and the cost of doing business with government tend to hinder market entry. In addition, the lack of analysis and forecasts of what the government will want in specific market segments hinders the involvement of new suppliers.

6.73 Overall, in our opinion, Treasury Board is not yet in a position to say that it is getting what it wants from competition, where it is used. Its expectations regarding competition are vague, and possibly unrealistic. Further, we found no one who regularly monitors the effects of competition in a meaningful way; an exception is the evaluation of the Open Bidding Policy, undertaken by PWGSC in 1996. The evidence suggests a relatively low level of unfair, ineffective or artificial competition.

Delivery — few incentives to meet promised terms

6.74 Senior officials rely heavily on certifications under section 34 of the *Financial Administration Act* to ensure that the government gets what it pays for. Internal audit reports and our own work, however, suggest that their assurance is not always warranted.

6.75 About half the internal audit reports we reviewed provided information about one or more of the results associated with delivery. About half of those reported problems that, in our view, are serious or very serious at the level of the unit being audited. In at least some of these reports, the internal auditors were called in to confirm or dispel senior management concerns. Accordingly, the overall extent of the problems may not be as great as the raw numbers suggest.

6.76 Most but not all of these problems were associated with contracts for services rather than goods. For example:

- “Activity Centre Managers [are] generally unclear on what they are certifying ... under S. 34 - receipt of goods, matching and verification of invoices, correct prices.”
- “Invoices and files do not support A) the number of hours worked; and B) contract deliverables - some deliverables were submitted, reorganized and resubmitted.”
- “Contractor evaluations, although required by policy, are often not completed.”
- “.. method of payment was not in accord with basis stated in the contract, or was unspecified.”

- “... absence of statements of work which clearly define deliverables and performance requirements .. and objective substantiation that full value was received for payments made.”
- “.. 91 percent of contracts reviewed [in this branch] were not completed in accordance with negotiated terms and conditions. One third had more than 50 percent increase in funding or 100 percent increase in time to complete.”

6.77 Data on contract amendments provide one tool to find poor delivery results. Analysis of amendment patterns suggests that most contracts turn out as initially expected, with service contracts being amended more often and for higher amounts than goods contracts. It is not entirely clear whether this is because requirements were poorly specified initially, the contractors were poorly managed, or contractors bid unrealistically. Contracts related to some departments and some suppliers are amended substantially more than others.

6.78 As reported in previous work of this Office, delivery on systems development contracts has been particularly problematic. The current state of monitoring and reporting on contracting performance provides few incentives for those contractors and departments who meet their contractual promises more consistently than the norm.

Cycle time — need to further analyze reasons for length

6.79 Many managers feel that it takes too long to arrange government contracts. To reduce cycle time, the Treasury Board Secretariat and Public Works and Government Services Canada have given departments more authority to arrange their own contracts, and have introduced standing offers and acquisition cards. We found little factual data to support this change in emphasis and action, or to gauge its success.

6.80 The limited evidence available suggests that Public Works and Government Services Canada cycle time has deteriorated over the last five years. PWGSC management considers that these changes reasonably reflect a number of factors including, among others, the effects of trade agreements and of increased delegation. A limited number of departmental re-engineering studies suggest that eliminating non-productive steps could cut cycle time by 40 to 70 percent.

6.81 In our sample (see Exhibit 6.7), contracts that were competed for took longer to arrange than sole-sourced contracts and call-ups against standing offers, as did contracts arranged through Public Works and Government Services. We recognize that there is a need for further analysis of the causes of extended cycle times.

Exhibit 6.7

(This exhibit is not available, see the Report)

Costs — higher administrative costs than necessary

6.82 Through its Program Review process, the government has committed itself to reducing the costs of administering contracts by about \$50 million per year. The evidence we have seen tends to confirm that the costs of arranging and administering contracts — which we estimate very roughly at about \$600 million per year — are higher than they need to be.

6.83 The limited cost and productivity data that are available suggest that these administration costs have risen appreciably over the last 10 years, despite the investments in technology and disproportionately to changes in contracting expenditures or activity (see Exhibit 6.5). A limited number of re-engineering studies suggest that some of the costs involved could be cut by as much as 50 percent. The evidence further suggests that the potential for savings is not evenly spread through the system.

Contribution to other objectives

6.84 Past audits of this Office have looked at the contribution of individually significant Crown projects (and contracts) to achieving socio-economic objectives. In this audit, we considered the cumulative effect of individually smaller contracts on a range of other objectives. Recent initiatives — in relation to alternative fuels and to Aboriginal set-asides (the policy to set targets for the level of Aboriginal procurement) — have sought to establish clearer procurement goals than in the past. It is too soon, however, to assess their impact.

6.85 Traditionally, procurement expectations relative to other objectives have been added without making clear the results expected and without measuring the results achieved. Expectations and information on results are generally too vague to support firm conclusions. Such evidence as is available suggests that efforts to promote -- or at least act consistently with -- stated objectives fall short of stakeholder expectations. However, departmental managers treat the absence of specific feedback from policy departments as confirmation of good results.

Conclusion and Recommendations

6.86 In our view, our most significant findings are those that relate to management direction, monitoring and reporting, and the work environment. These are framework issues: they bear on Treasury Board's ability to discern whether contracting is getting better or worse, to manage shared responsibilities, and to agree about priorities for improvement. And they bear on the ability of all departments to achieve good contracting results.

6.87 These issues were perhaps less important when Treasury Board could assume that maintenance of the status quo was an appropriate strategy. Today, they constrain the ability of individuals and organizations to respond appropriately to a fast-changing environment and to deliver the kind of high performance results (at low cost) that governments need to be able to deliver and demonstrate. Contracting needs better direction and support, and more focus, if it is to change past patterns without compromising the traditional values of integrity and probity.

6.88 Improving contracting performance is not simply a technical issue for bureaucrats or procurement specialists. Constraints to better contracting (and to more honest reporting about contracting performance) are complex, long-standing and deeply embedded. Not all of them fall within the scope of this audit, although they must be considered in any realistic attempt to improve performance.

6.89 Because of the nature of the constraints, the variations among individual departments, and the changing environment of government contracting, we do not believe that better contracting will come from simple solutions, or from "one size" models designed to fit all circumstances at all times. Hard choices and fine distinctions will have to be made: about what to contract; about where it is worth investing focussed management attention to achieve contracting excellence; and about how to balance concern for results with due process.

6.90 Continuing delegation of contracting authority by the Treasury Board and of procurement authority by Public Works and Government Services Canada have made line departments increasingly responsible for making those choices, and for identifying and acting on opportunities and problems. The Treasury Board Secretariat can help them by providing them with the right tools.

6.91 **The Treasury Board Secretariat should provide departments with:**

- **a policy framework within which to work that reflects departmental differences and establishes clearer performance goals, where appropriate;**
- **better ways of managing long-standing tensions among the responsibilities, expectations and authority of individuals and organizations; and**

- **a framework for management reporting that is better related to assigned responsibilities and expectations for performance, and is supported by consistently defined, credible performance information.**

6.92 We have been impressed by the way public reporting, whether or not required by law, can influence behaviours as well as inform those outside of government. There is a need for an impetus for improvement, an opportunity to debate on the relative importance of different results, and a continuing focus on contracting performance.

6.93 **The government should improve its reporting to provide Parliament with a periodic overall assessment of contracting performance and priorities, showing the progress made.**

***Treasury Board Secretariat's response:** In contracting policy, as in other policy areas, the Treasury Board is providing more authority, flexibility and optionality to individual departments and agencies. This approach will enable them to effectively deliver their programs within a solid but high-level and strategic policy framework. The cornerstones of the contracting policy framework are well defined and basically entail the use of contracting to effectively meet operational and program needs and obtain best value in a fair and open manner, and to meet other national objectives of the government. These principles have recently been reinforced by Canada's international and internal trade agreements and their related contract dispute resolution mechanisms. Within this policy framework, departments will have the flexibility to achieve good program results, balanced with due process and integrity in contracting. Departments and agencies will be further encouraged to develop implementation tools and processes suitable to their individual requirements and to set performance goals, taking into account the policy framework, as well as their operational and program delivery objectives. Finally, the Treasury Board supports improved contract reporting with periodic overall assessment of contracting performance and priorities, to the extent feasible and practicable within given resources.*

***Public Works and Government Services Canada's response:** Public Works and Government Services Canada is currently working with the Treasury Board Secretariat to review the procurement policy frameworks and responsibilities. Results of these discussions will, without doubt, contribute to a clearer understanding among all stakeholders of responsibilities, expectations, authorities and accountabilities.*

Initiatives such as the recent implementation of an automated contracting reporting tool in all departments should also contribute more accurate and comprehensive contracting statistics on a government-wide basis.

About the Audit

Objective

The objective of our audit was to inform Parliament about the government's contracting performance.

Scope and Approach

We examined the policy and framework responsibilities of the Treasury Board Secretariat and Public Works and Government Services Canada -- their performance in setting the framework for government contracting and in providing leadership and direction to the rest of government. These responsibilities derive from:

- section 7 of the *Financial Administration Act*, which authorizes Treasury Board to act on behalf of Cabinet in matters of common administration, including the inherent right of ministers to buy goods and services; and
- section 7 of the *Public Works and Government Services Act*, which directs the Minister to plan and organize the provision of goods and services.

We based our examination of the accountability framework on the criteria described on the following pages. Against them we considered information derived from:

- an analysis of the provisions of the policy itself, focussing on the Treasury Board policy documents together with those of Public Works and Government Services and four other departments;
- the findings of internal audit reports dealing with contracting in the government over the last five years and of past audits by the Office;
- testimony and proceedings of the Standing Committees on Government Operations and Public Accounts; and
- interviews with officials in Treasury Board Secretariat, Public Works and Government Services Canada, three policy departments and seven line departments.

To examine the results achieved by those working within the policy framework provided by Treasury Board and Public Works and Government Services Canada, we considered the information from the above sources, plus:

- review and analysis of the government's contracting and public accounts data;

- analysis of documents provided by, and discussions with, officials in Correctional Service Canada, Fisheries and Oceans Canada, Health Canada, National Defence, Natural Resources Canada, Revenue Canada, and Transport Canada; and
- analysis of more than 250 contracts on which four departments made payments of \$69 million in 1995-96.

We did not examine construction, real estate or travel contracts.

Criteria and Performance Indicators

The criteria that we applied are set out below, together with the supporting subcriteria and quantitative results indicators considered. These criteria were derived as follows. The first four, which deal mainly with framework results, are based on criteria promulgated by CCAF–FCVI Inc. Legislative auditors and managers in a number of other jurisdictions have tested and applied these criteria in a variety of situations.. They are supported by subcriteria that we have discussed with Treasury Board Secretariat officials and tested in previous audits of administrative policy.

The remaining criteria deal with more operational results. We developed them specifically for this audit, reviewed them with managers and other stakeholders, and agreed on them with Treasury Board Secretariat and Public Works and Government Services Canada. We considered an additional criterion when looking at contracts involving information technology services: *the extent to which government contracting protects government information and intellectual property*. However, we did not pursue our work to an overall conclusion against this criterion.

Criterion	Subcriteria	Results Indicators
Management direction. The extent to which the contracting objectives of the government are clear, well understood and well integrated into the government's plans, structures, delegations of authority and decision making.	<ul style="list-style-type: none"> • The extent to which responsibilities are clearly assigned • The extent to which performance expectations are clear • The extent to which authority (and other resources) are delegated commensurate with responsibility and expectations 	<ul style="list-style-type: none"> • policy statements • mandates & mission statements • authority delegations • plans and targets • prohibitions • everyone understands what is expected of him or her
Monitoring and reporting. The extent to which contracting performance is monitored, reported and acted upon.	<ul style="list-style-type: none"> • The extent to which monitoring and reporting identifies opportunities to buy smarter • The extent to which there is relevant and reliable reporting on the discharge of contracting responsibilities • The extent to which there is reasonable review of contracting performance 	<ul style="list-style-type: none"> • reporting frameworks • data definitions • data and aggregations • interpretations and analyses • actions in response to information
People and working environment. The extent to which the government	<ul style="list-style-type: none"> • The extent to which good and poor performance are recognized 	<ul style="list-style-type: none"> • assessments of skills and training needs, plans

Criterion	Subcriteria	Results Indicators
provides appropriate incentives, sanctions and development opportunities to sustain a skilled and competent contracting work force.	<p>and responded to</p> <ul style="list-style-type: none"> • The extent to which steps are taken to identify, maintain and improve needed skills 	<ul style="list-style-type: none"> • training delivered • certifications • incentives and sanctions applied
Other resources and tools. The extent to which contracting processes and tools provided are appropriate to achieve the desired contracting performance.	<ul style="list-style-type: none"> • The extent to which processes, information resources, standard specifications and conditions help officials and suppliers produce good results • The extent to which contracting processes and tools are produced at reasonable cost 	<ul style="list-style-type: none"> • utility (complaints, assessments) • (costs)
Screening. The extent to which contracting screens out requests for goods and services that are unacceptable, unduly expensive, or unnecessary, so that the federal government buys -- with integrity -- only what it needs.	<ul style="list-style-type: none"> • The extent to which “needs” are separated from “wants” • The extent to which contracts reflect requirements • The extent to which restricted or prohibited transactions are detected and prevented 	<ul style="list-style-type: none"> • Requisitions rejected, advice given (taken and rejected) • changes in specifications or source strategy • savings achieved • prohibited or unauthorized transactions processed (negative) • amendment rates (poor specifications)
Competition. The extent to which competition (when used) is open, fair and gets good value.	<ul style="list-style-type: none"> • The extent to which competition is used • The extent to which prices are negotiated when competition is not practicable • The extent to which competition attracts the best qualified suppliers • The extent to which the government treats fairly those who compete • The extent to which competition secures savings (or better value) 	<ul style="list-style-type: none"> • new suppliers attracted • turnover of supplier pool • number of bidders and bid spread • quality assurance reviews • rate of complaints and disposition
Delivery. The extent to which government contracting delivers what was agreed, when it was agreed, and for the price agreed.	<ul style="list-style-type: none"> • The extent to which the government gets what it contracts for (in terms of cost , quality and time) • The extent to which suppliers get what they contract for 	<ul style="list-style-type: none"> • payment certifications • contractor evaluations • amendments • contract audit results • supplier sanctions and incentives applied
Cycle time. The extent to which the government arranges contracts in a timely manner.	<ul style="list-style-type: none"> • The extent to which cycle time meets user requirements and operational needs 	<ul style="list-style-type: none"> • time from requisition to approval • time from approval to tender

Criterion	Subcriteria	Results Indicators
	<ul style="list-style-type: none"> The extent to which cycle time relates to value added 	<ul style="list-style-type: none"> time from tender to award
<p>Administrative costs. The extent to which the federal government arranges and administers contracts at a reasonable cost to all participants.</p>	<ul style="list-style-type: none"> The extent to which costs incurred should be monitored and controlled The extent to which costs should be reasonable in the light of performance expected 	<ul style="list-style-type: none"> costs to government (direct, overhead, management) costs to suppliers
<p>Contribution to other objectives. The extent to which contracting contributes to -- or does not undermine -- other objectives.</p>	<p>(Depending on the mechanisms adopted)</p> <ul style="list-style-type: none"> The extent to which target volumes of business reach designated beneficiaries The extent to which government avoids restricted or prohibited uses of contracts (<i>see screening</i>) The extent to which the government buys goods or services with preferred specifications The extent to which standard terms and conditions are applied The effect of aggregation and disaggregation on supplier groups (<i>see competition</i>) 	<ul style="list-style-type: none"> volume of business incidence of prohibited transactions (<i>see also screening</i>) percent application of standard terms and conditions proportion of "total buy" meeting desired specifications

Audit Team

Michael Weir
 Jaak Vanker
 Alain Boucher
 Joe Reperto
 Gerry Nera
 Tony Brigandi
 Holly Shipton
 Marjorie Pound
 Cyril Lee-Shanok
 Barry Neilson
 Janet Hatt
 Rosemary Marenger

For information, please contact Shahid Minto, the responsible Assistant Auditor General.

Chapter 7

Acquisition Cards

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Acquisition Cards

Assistant Auditor General: Shahid Minto

Responsible Auditor: Trevor R. Shaw

Main Points

7.1 Acquisition cards are a recent instrument of purchase in the federal government. The use of cards has grown rapidly since 1991 and continues to grow. During 1996, approximately 20,000 cards were used to acquire \$172 million of goods and services.

7.2 The use of cards has made it difficult to apply traditional financial controls, such as segregation of duties. Essential control cannot be achieved if organizations do not monitor and analyze cards, record and match charges, and carry out periodic audits and verifications of card transactions. We found room for improvement in all these areas. In particular, better information and increased use of electronic tools are needed to modernize control over cards.

7.3 Although available measurements do not point to serious losses at the present time, the severity and number of problems could increase if organizations do not strengthen control and share best practices. Now is the time for the government to assess the card program for emerging risks and the management control processes that should be applied.

Introduction

7.4 Our 1996 audit of materiel management in the federal government included some preliminary work that identified problems with the use of acquisition cards. We have conducted a separate audit of these cards and report the results in this chapter.

7.5 A government acquisition card is a credit card that is used to purchase and pay for goods and services for federal departments and agencies. Organizations issue a card to an employee, but the card account remains the responsibility of the Crown. A department, branch or division of the public service of Canada pays the card account.

7.6 Acquisition cards are an instrument of purchase placed in the hands of individual public servants. When they are used, they commit the Crown to an irrevocable obligation to pay. During 1996, cards were used by public servants to make over 615,000 transactions valued at \$172 million.

7.7 Since the introduction of cards, their use has grown rapidly and continues to grow. In 1992, about 2,000 cards were issued. Today, approximately 20,000 cards are used by public servants in over 70 departments and agencies. The majority of transactions are for small amounts, less than \$150. About 5 percent of card transactions exceed \$1,000 and account for 44 percent of the total dollars spent on cards.

7.8 **Acquisition cards represent an important change in the way government organizations acquire and pay for goods and services.** The Treasury Board officially launched the acquisition card program in December 1991 as a government-wide initiative. The use of cards was promoted by the Treasury Board Secretariat as an innovation in keeping with the objectives of Public Service 2000, and with the basic aim of reducing administrative costs and enabling employees to purchase certain goods and services more directly.

7.9 Before cards were introduced, employees arranged for small purchases using inefficient paper-driven systems based on numerous purchase orders. Rather than have departments process many purchase orders and pay individual suppliers, the intent was to consolidate purchasing through credit cards and to pay card companies once a month. Several benefits were expected, including shorter procurement times and a reduction in the number of supplier invoices and payments.

7.10 Organizations can issue a card to any employee. Cards are used to buy such diverse items as computers and software, tools and hardware, equipment and furniture, office and maintenance supplies, training services, fees and subscriptions, storage services, as well as food and field supplies. According to Treasury Board policy, acquisition cards are not to be used for travel and vehicle operations because other cards are contracted for these purposes. Also, cash advances are not to be obtained using acquisition cards.

7.11 **Focus of the audit.** The objective of our audit was to determine whether there has been appropriate control over the use of acquisition cards. Further details on audit scope and approach can be found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Better Control Procedures Needed

7.12 A number of conditions are attached to issuing a card. First, there must be authority to issue and use the card. Second, the card should be issued because it is needed, with a credit limit commensurate with the intended

card use. Third, the employee should formally accept responsibility for the card and agree to comply with relevant authorities, policies and procedures. Finally, the employee should be expected to protect the card and use it with prudence and probity.

Control varies among organizations

7.13 Organizations have authority to use cards and have issued administrative policies and procedures. However, we found that control varies among the four organizations we audited, with some weaknesses in basic areas. For example, departmental policies are sometimes inconsistent with Treasury Board policy; acknowledgment forms are not always clear about what employees are agreeing to when they are issued a card; the control duties of card co-ordinators have not been uniformly determined or documented; few organizations have a cross-checking procedure to ensure that when card holders leave or transfer, their cards are promptly cancelled; and few organizations are tracking to ensure that a minimum level of instruction is being given to all card holders.

Organizations need to analyze card use

7.14 A decision to issue a card to an employee is made at the discretion of the individual manager. Departments have not developed guidance to assist in determining the need for cards and what credit limits would be appropriate. Now that cards have reached 20,000 in number, departments need to know whether those possessing cards need them, or whether those who should be using them are doing so. Information has to be obtained to analyze who uses cards, how frequently they are used, and what is being bought. This would help organizations determine if more control risks are being assumed than are necessary to achieve the intended benefits of cards.

Improved monitoring and analysis are needed

7.15 The use of cards has made it difficult to apply traditional financial controls, such as segregation of duties. For example, individuals can now commit public money, procure and receive goods and services, and then later certify the charges made to their card accounts. Essential control cannot be achieved if organizations do not monitor and analyze card use, record and match charges, and carry out periodic audits and verifications of card transactions. We found room for improvement in these areas.

7.16 Managers sometimes do not exercise second-level review and scrutinize transactions when subordinates certify their own card accounts pursuant to section 34 of the *Financial Administration Act*. Organizations do not monitor and follow up card accounts that are inactive, or are suddenly used after lying dormant. Departments also need to identify unusual patterns of card use, and to determine whether card practices are improving and whether errors are staying within tolerable limits. Finally, while Treasury Board policy requires departments to carry out internal audits of card use, we identified only ten such internal audits of cards across government since 1995, six of which were done recently at the base level within National Defence.

7.17 We scanned hundreds of card statements in the four organizations audited and conducted detailed tests of over 260 transactions. Problems observed were lack of evidence of control procedures and incomplete documentation of card purchases, cards being used to make purchases that are restricted by policy, uncertainty as to whether the card was used only by the card holder, no evidence of inventory items being recorded in the inventory management system, and purchases exceeding authority limits.

7.18 Control processes also need to be enhanced to prevent or detect improper card use. For example, a recent survey of about 70 entities by the Treasury Board Secretariat shows that 21 cards were reported by departmental card co-ordinators as lost or stolen. Unfortunately, co-ordinators are not necessarily in a position to know accurately how many cards have been lost. We determined from data files for the last six months of 1996 that at least 680 cards were replacement cards. This indicates that cards are lost or damaged at a rate of three percent —

more than reported to the Secretariat. Organizations cannot say for certain how many cards have been lost. They need to determine the reasons for replacement cards and track their experience with lost cards.

7.19 Finally, data analysis indicates that payments on at least 800 card accounts were past due as of October 1996. Late payment interest totalling \$79,121 was charged to federal organizations between August 1996 and December 1996.

7.20 All of the above-noted information signals risks. The available measurements do not point to significant amounts of damage or loss at the present time. However, with the growing use of cards and hundreds of thousands of highly diversified transactions, problems could go undetected until departments and agencies improve control and reduce the risk of losses in the future.

Increased use of electronic tools would enhance control

7.21 Given the nature and extent of card use, information becomes key to modernizing control over cards. Organizations have little information readily available to efficiently and effectively monitor the use of cards in terms of identifying unusual transactions and analyzing the pattern of card use (who is buying what, and where). While card use has grown enormously, only seven organizations have any form of electronic information or data interchange with card companies. Of the four departments we audited, only Natural Resources Canada has established electronic data interchange for nearly all of its card accounts. Moreover, new technology offers the opportunity to enhance control over card transactions.

Assessing Benefits and Sharing Best Practices

Extent of net benefits is uncertain

7.22 Only one (Natural Resources Canada) of the four organizations we audited was comparing its actual use of cards with the potential use of cards and measuring administrative savings that were being achieved. None of the four has determined whether or not economical purchasing is being maintained in the use of cards as part of overall purchasing activity. The Treasury Board Secretariat has not attempted to measure productivity gains or losses from the use of cards.

Organizations could benefit from sharing best practices

7.23 Our audit findings suggest that organizations could benefit from the sharing of best practices and from guidance on what constitutes effective control over cards. We observed people learning in isolation from each other without a mechanism to transfer and multiply best practices.

Conclusion

7.24 Our audit found that, while the use of acquisition cards has grown rapidly, federal entities have not been sufficiently prepared to manage the risks arising from card use. Much can be done to reduce risks and to pursue more rigorously the benefits of card use.

7.25 Although there do not appear to have been serious losses at this time, the severity and number of problems could increase if organizations do not modernize and strengthen control over the use of cards. Now is the time for the government to assess the card program for emerging risks and the control processes that should be applied.

7.26 Departments and agencies should review their strategies and plans for the use of acquisition cards. Each organization should analyze the use of cards and decide what controls would best meet its needs and risks.

7.27 The Treasury Board Secretariat and Public Works and Government Services Canada should continue to work together with other federal organizations, card companies, and suppliers to improve the card program and strengthen control.

Royal Canadian Mounted Police's response: *The RCMP has, this past year, conducted a workshop for division acquisition card co-ordinators. A National Co-ordinator for the Acquisition Card Program has been identified. The National Co-ordinator is responsible for ensuring that monitoring and control procedures over the issuance of cards are carried out by the division acquisition card co-ordinators.*

Liaison between Materiel and Services Branch and Finance Branch personnel is also in place to ensure that RCMP policy is consistent with Treasury Board policy relative to the use of acquisition cards. A consolidated billing procedure for acquisition card purchases has been implemented to facilitate timely payment of monthly invoices. The card program will be supported further through increased emphasis on the Quality Assurance Review program currently being developed for the Finance and Supply Directorate areas of responsibility.

Department of National Defence's response: *DND, like Natural Resources Canada, also has in place an automated accounts payable system for processing monthly electronic invoices from MasterCard, the principal acquisition card used in this department. By June 1997, all DND acquisition card invoices will be processed electronically.*

Although DND has not yet quantified the administrative savings specifically attributable to the use of acquisition cards, the benefits are clearly there. The use of acquisition cards results in a single monthly, departmental electronic invoice containing thousands of charges paid with one cheque. If the cards were not used, this same purchasing activity would have resulted in hundreds of manually processed cheque requisitions. As well, we have frequently received informal feedback from our managers that acquisition cards have allowed them to purchase faster, smarter and more economically.

DND's current departmental policies are consistent with and amplify those of the Treasury Board. However, we agree that certain improvements to our control and reporting processes may be warranted to reduce the potential risk of misuse or abuse of the cards.

Natural Resources Canada's response: *Natural Resources Canada is an advanced user of acquisition cards and electronic data interchange and is committed to continuous improvement of control processes. Our internal audit group, who assisted the Office of the Auditor General in its review, indicates that our controls are reasonable. As noted in the chapter, the Department is a source of emerging best practices and agrees with the recommendation that departments should share their best practices.*

Public Works and Government Services Canada's response: *Public Works and Government Services Canada, as the common service provider for contracting card services, will continue to improve our services to our clients.*

About the Audit

Objective

The objective of our audit was to determine whether there has been appropriate control over the use of acquisition cards in the federal government.

Scope and Approach

We audited the card activity of four entities — National Defence, the Royal Canadian Mounted Police, Fisheries and Oceans Canada, and Natural Resources Canada. These organizations account for about 54 percent of current card purchases. We reviewed policies and systems, available studies and internal audit reports, and conducted detailed tests of card transactions within these four entities. We did not conduct tests to determine if an economical price was obtained in card purchases.

We also reviewed certain functions of the Treasury Board Secretariat and Public Works and Government Services Canada as the central agencies responsible for card policy and for contracting card services. In addition, we analyzed government-wide data as made available by the Treasury Board Secretariat and by one of the banks that issues government acquisition cards. We did not audit the use of travel cards and vehicle operating cards.

Audit Team

Brian Brisson
John Cathcart
Nathalie Chartrand
Wing Shing Ma
Tony Shaw
Gordon Stock

For information, please contact Shahid Minto, the responsible Assistant Auditor General.

Chapter 8

Department of Finance — Equalization Program

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Department of Finance — Equalization Program

Assistant Auditor General: Ron Thompson

Responsible Auditor: Jeff Greenberg

Main Points

An essential element of citizenship [in the Canadian federation] must be relatively equal access to basic government services, irrespective of place of residence.

Royal Commission on the Economic Union and Development Prospects for Canada, 1985

8.1 This fundamental principle is still the driving force behind the federal government's 40-year-old equalization program, which in 1996-97 transferred \$8.5 billion in unconditional funds to the relatively poorer provinces. Equalization is a responsive program that requires continuing attention and refinement if it is to stay true to its objective.

8.2 Since its purpose is to equalize provincial revenue-raising capacity, the key to its success rests on how well the Representative Tax System, the basis for this program, reflects provincial tax systems. As a result, the program must adapt to the constant evolution of these systems. The legislation requires that the program be renewed at least every five years, providing the federal government, in conjunction with the provinces, with a built-in opportunity to keep the program current. We found that this process works, but that it could be more effective if the federal-provincial committee on equalization began its review of outstanding issues earlier in each new equalization period.

8.3 We believe that there must be a solid basis for knowing how and why the program should change. In this regard, we suggest that there should be guiding principles for the construction of the Representative Tax System and for aspects of the ceiling and floor, two provisions that limit fluctuations in the payments.

8.4 Because final decisions about this program rest with Parliament, we believe that the Department of Finance should make a greater effort to educate Parliament, and the public in general, about how this very complex program works. We also believe that it could use Parliament more effectively, soliciting advice from a wider circle of interested parties, rather than relying almost exclusively on the advice of a committee of federal and provincial officials.

8.5 We found that the administrative process by which entitlements are calculated and payments made is reasonable. However, we noted that outstanding balances owed by provinces to the federal government currently bear no interest, resulting in an additional benefit to the provinces of about \$38 million in 1995-96. We believe that the government should review its policy of interest on outstanding balances owed to, or by, the federal government.

8.6 We were frequently reminded by officials that the equalization program is important to the Canadian federation. However, this program is only as good as the processes that allow it to keep pace with the shifting sands of provincial tax systems. We believe that the current program and its processes for change work reasonably well, but they could be improved. This is both a challenge and an opportunity for the government, and the Parliament it serves.

Introduction

8.7 Transfer payments to the provinces have been described as the “glue” that holds the country together. They constitute the second-largest federal spending program, exceeded only by interest charges on the federal debt. In 1996-97, federal cash transfers to the provinces amounted to an estimated \$23 billion, or 15 percent of total federal spending. In addition to these cash payments, the federal government provided the provinces with approximately \$13 billion in tax transfers — that is, the cash value of tax points ceded by the federal government to the provinces to enhance their capacity to finance social services.

8.8 At \$8.5 billion, payments under the equalization program, which is administered by the Department of Finance, account for over one third of total cash transfers to the provinces. Since the program was first adopted in 1957, all provinces but Ontario have qualified for equalization transfers at one time or another. Currently, seven provinces — all except Ontario, Alberta and British Columbia — receive equalization transfers. Exhibit 8.1 shows the growth, and the distribution by province, of equalization payments over the past decade.

Exhibit 8.1

Total Equalization Entitlements

1986-87 to 1996-97 (\$ Millions)

	1986-87	1988-89	1990-91	1992-93	1994-95	1996-97
Newfoundland	678	839	919	886	950	956
Prince Edward Island	138	177	194	168	190	188
Nova Scotia	620	835	949	908	1,059	1,129
New Brunswick	643	771	868	870	917	904
Quebec	2,942	3,393	3,627	3,589	3,868	4,017
Manitoba	471	795	914	872	1,079	1,039
Saskatchewan	285	457	531	490	413	259
Total	5,775	7,267	8,002	7,784	8,476	8,493

Numbers may not add due to rounding

Data Source: Department of Finance

8.9 Equalization payments are unconditional transfers to the provinces; that is, the receiving provinces are free to use the funds as they please. Payments are made on the basis of a formula that estimates the capacities of provinces to raise revenues by taxes and other levies, and compares them with a standard. Any province whose fiscal capacity is lower than the standard is entitled to equalization payments sufficient to raise its capacity to the standard.

8.10 The principle of making equalization payments has been enshrined in the Constitution since 1982. Specific authority for the equalization program is provided under Part I of the *Federal-Provincial Fiscal Arrangements Act*. The program is normally renewed every five years. The present program came into effect in 1994 and is due to expire in 1999.

Historical Context

An essential element of citizenship [in the Canadian federation] must be relatively equal access to basic government services, irrespective of place of residence.

8.11 Canada is a vast country with a political structure composed of two orders of government, each sovereign within its own sphere. The responsibilities and authorities that each order possesses are set down in the Constitution of Canada. These include responsibility for providing public services as well as authority to raise revenues to do so.

8.12 Even as far back as 1867, there was recognition that the balance between spending and revenue-raising capacities was uneven and that the provinces would need substantial help from the Dominion government to carry out their financial responsibilities. This help came in the form of annual cash transfers, or subsidies as they were usually referred to at that time. Chief among these were per capita grants, fixed at 80 cents per resident of each province up to a maximum of 400,000 persons.

8.13 The terms of these arrangements were written into the *British North America Act* — now called the *Constitution Act (1867)* — and the subsidies agreed upon were declared to be “in full Settlement of all future Demands on Canada.” If the provinces chose to increase their expenditures materially, it was intended that they obtain their additional revenues entirely from the revenue sources allotted to them.

8.14 As permanent as these financial arrangements were intended to be, they simply could not stand the test of time. The social responsibilities of the provinces that sprang up in the first part of the 20th century, and the need for revenues to meet them, became a growing source of discontent between the federal and provincial governments.

8.15 In 1937, the Royal Commission on Dominion-Provincial Relations (Rowell-Sirois Commission) was established to assess this discontent and to make recommendations to address it.

8.16 One of the recommendations the Commission made in its 1940 report was that the Dominion government make annual “national adjustment grants” to the needy provinces, “to make it possible for every province to provide for its people services of average Canadian standards” without having to resort to excessive taxation. The grants would be unconditional and the provinces would be free to decide how to spend them, or whether to use them to reduce provincial tax rates.

8.17 World War Two suspended any decision to implement the Commission’s recommendations. Responding to the wartime emergency, all provinces agreed to relinquish to the federal government their personal and corporate income taxes for the duration of the war in return for certain guarantees and payments related to these revenue losses. These “tax rental” agreements were the precursors of the federal-provincial tax sharing and collection agreements that exist today.

8.18 At the end of the war, in spite of significant objections by the premiers of Ontario and Quebec, the federal government continued its dominant fiscal position created by the wartime tax rental agreements. The basis for its insistence on this role in the economy was the emerging prominence of the Keynesian argument that a strong central fiscal policy was needed to promote economic stability and full employment. In return for this taxing power, the federal government put into place a system of payments of unconditional per capita grants to all the provinces except Ontario and Quebec, who refused to participate.

8.19 In 1951, the tax rental agreements were extended for another five years. This time, Ontario was also brought into the scheme, leaving Quebec as the sole hold-out.

8.20 In 1957, the equalization program that Canadians know today came into being as part of the federal-provincial fiscal arrangements legislation. That legislation included the following financial provisions:

- continuation of the tax rental agreements, with a provision for a federal tax abatement to those provinces unwilling to participate;

- stabilization payments to protect provinces against unusual year-over-year declines in revenue due to economic events; and
- equalization grants to each province to bring its per capita yield from personal and corporate income taxes and succession duties to the level of the two richest provinces (at the time, Ontario and British Columbia).

Primary Objective of the Equalization Program

Comparable revenue-raising capacities

8.21 Section 36(2) of *The Constitution Act (1982)* sets down the fundamental objective for the equalization program. It states:

Parliament and the Government of Canada are committed to the principle of making equalization payments to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation.

8.22 The main objective of the program, based on how the government has interpreted this clause, is that after equalization payments are made, no province should have a revenue-raising capacity below a specified standard.

8.23 This does not mean that the revenue raising capacities of all provinces should be the same. If that were true, then payments would have to be based on the revenue-raising capacity of the wealthiest province.

8.24 Nor does it mean that receiving provinces should have comparable per capita revenues. The intention of the program is to raise the *capacity to tax* on a per capita basis, not the actual per capita revenues collected by taxation. The only way the capacity to tax and the actual revenues collected on a per capita basis would be comparable is if all provinces had identical tax systems.

8.25 This objective was written into the 1982 revisions to the *Constitution Act*, but it had already been accepted in 1957, when the program was first adopted. The 1957 agreement specified that any province would be entitled to equalization payments if the per capita revenues it could collect from a common set of taxes were lower than the revenues this same set of taxes would generate if applied to some standard or average of the provinces. At that time, the set of taxes included only three revenue sources — personal income tax, corporate income tax and succession duties.

8.26 In 1967, the revenue base was expanded to be more representative of provincial tax systems. This new base, known as the Representative Tax System (RTS), included a total of 16 separate revenue sources. Subsequently, municipal revenues were also brought into the formula. Today, the RTS consists of 33 separate revenue sources, ranging from income taxes to insurance premiums, from property taxes to payroll taxes, and from sales taxes to “sin” taxes.

8.27 In 1957, the standard against which all provinces were to be compared was the average tax base from the three revenue sources of the two wealthiest provinces, Ontario and British Columbia. Ten years later, the standard was changed to an average of all 10 provinces. In 1982, it was changed again to an average of 5 provinces (British Columbia, Saskatchewan, Manitoba, Ontario and Quebec), where it stands today.

Secondary Objectives of the Program

8.28 In addition to the primary objective of the program, which has its roots in the Canadian Constitution, the Department of Finance has established a number of secondary objectives for the program. Three of these — sustainability, stability and accountability–responsibility — are discussed below.

Sustainability

8.29 The concept of sustainability implies that if a program is to remain financially viable, its long–term payout ought not to exceed some norm that the government considers acceptable.

8.30 With the energy crisis of the 1970s and the resulting significant growth in equalization payments, the federal government faced a sustainability problem that led to two major changes in the program. The 1982 revisions established a ceiling on expenditures and changed the standard from a 10–province average to a five–province average, which excluded resource–rich Alberta and the four relatively poor Atlantic provinces. Both changes were made to ensure that the program costs would no longer fluctuate as widely as they had in the mid–1970s.

8.31 The ceiling prevented the percentage growth in equalization payments from exceeding the percentage growth in gross national product (GNP).

Stability

8.32 The concept of stability implies that the payouts of the program to individual provinces will be free of large and destabilizing fluctuations.

8.33 The concern about stability stems mostly from provincial concerns that, while the federal government had included safeguards to prevent its spending from getting out of control, there was no cushion to protect provinces against sharp declines in their transfers. The result was the introduction of a set of “floors” to dampen year–over–year reductions in equalization entitlements.

Accountability–responsibility

8.34 While the Department of Finance is accountable to Parliament for this program, there is no such relationship between the federal government and its provincial counterparts. The provinces do not have any obligation to the federal government to account for their use of equalization funds, nor does the federal government have any obligation to the provinces other than to comply with the terms of the program legislation and section 36(2) of the Constitution.

8.35 Nevertheless, the federal government does have a responsibility to keep the provincial governments fully informed about factors that could affect equalization, and to consult with them in a meaningful way on the quinquennial renewal of the program (the next is in 1999).

8.36 These “accountability–responsibility” relationships with Parliament and the provincial governments are examined later in the context of the reasonableness of the quinquennial review process.

The Workings of the Equalization Formula

8.37 The concept of equalization is essentially simple: to measure each province's capacity to raise revenues, and to compare that capacity with some provincial average or standard. Provinces with capacity below the standard receive payments to bring it up to the standard.

8.38 The basic principle used to calculate payments is also quite simple. Using personal income tax as an example, suppose that the revenues from the personal income tax for all provinces total \$40 billion. If these revenues were based on taxable income of \$200 billion, then the average tax rate would be 20 percent.

8.39 The calculation of revenue-raising capacity and comparison with the standard is done on a per capita basis. For example, suppose Province A has an average taxable personal income (known as the per capita tax base) of \$30,000, whereas the standard (the five-province average) is \$35,000. Using the average tax rate, Province A could raise \$6,000 per capita from personal income tax; the five-province standard would be \$7,000. This would leave a gap of \$1,000 to be equalized. If Province A had a population of 1 million people, it would be entitled to an equalization payment of \$1 billion for personal income taxes. The same process is followed for each of the other 32 revenue sources. All the differences against the five-province standard, both positive and negative, are added and the net figure determines whether the province will receive equalization (for a mathematical description of the program, see Exhibit 8.2).

Exhibit 8.2

How Equalization Entitlements Are Calculated

A province's equalization entitlement from a revenue source is determined according to the following equation:

$$E_a = T_b(B_r - B_a)P_a$$

Where:

- E_a = Equalization entitlement to province A
- T_b = The average tax rate on revenue source B for all provinces
- B_r = The per capita base for source B of the five "representative" provinces
- B_a = The per capita base for source B of province A
- P_a = The population of province A

Using the example in paragraphs 8.38-8.39,

- T_b = The 20 percent tax rate on income
- B_r = The five-province per capita personal income tax base of \$35,000
- B_a = The per capita income in Province A of \$30,000
- P_a = The population of 1 million in Province A

Substituting these values into the equation yields equalization payments of \$1 billion for revenue source B.

This is an illustration for one hypothetical revenue source only. In fact, there are 33 separate revenue sources in the equalization formula, comprising essentially all tax and non-tax levies imposed by provincial and local governments. Entitlements from each are calculated as above and aggregated to determine a province's overall entitlement.

8.40 Calculating equalization for a revenue source like personal income tax is straightforward because the base — taxable income — is essentially common across all provinces. For many of the other revenue sources, however, the bases are not so straightforward. For example, some provinces calculate their payroll taxes (which are used primarily for health benefits) on a business's total payroll, while others tax a portion above a certain threshold, and still others charge no tax at all. Yet for purposes of the RTS, the base chosen must be common across all provinces.

8.41 Where various provinces tax a revenue source differently, it is necessary to arrive at a common way of estimating the tax base in order to calculate the equalization payments. In some areas there is general agreement among the provinces on the way Finance does this, while in others no consensus exists. Finance nevertheless has to establish a base despite the lack of consensus. Examples include property tax (see paragraphs 8.66–8.76) and resource taxes on, for example, lumber and oil (see paragraphs 8.60–8.64).

8.42 To further complicate the program, a ceiling was introduced in 1982 to meet the federal concern that equalization transfers not grow at a faster rate than the economy. At the same time, a set of “floors” was established at the request of the provinces to ensure that the transfers to any one province would not fall sharply from one year to the next.

8.43 These complexities — the difficulties in calculating the bases for some taxes, and the existence of a ceiling and the floor provision — take this program from one of conceptual simplicity to one of practical complexity that leaves many observers bewildered.

Focus of the Audit

8.44 Our audit focussed on the systems and practices that the Department of Finance has in place to assess performance, to keep Parliament informed and to administer the equalization program. Further details on the audit scope, objectives and methodology are found at the end of the chapter in the section **About the Audit**.

Observations And Recommendations

Achieving Comparable Revenue–Raising Capacities

8.45 The key element in the equalization formula and its successful operation is the Representative Tax System (RTS). The RTS is a hypothetical tax system that is intended to be representative of the actual systems of the separate provinces. Its purpose is to provide an accurate and comparable measure of the relative ability of provinces to raise revenue to support public services.

Principles for a representative tax system

8.46 Exhibit 8.3 shows that the equalization program has achieved comparability in the RTS for seven of the ten provinces. However, to know whether this is a fair reflection of its performance, the Department has to be satisfied that the RTS meets a number of criteria. Specifically, the RTS ought to be comprehensive, representative, appropriately categorized and accurate.

Exhibit 8.3

(This exhibit is not available, see the Report)

- **Comprehensive.** To be comprehensive, the RTS would include all revenue sources used to support public services. Partial coverage of the revenue sources used would yield a biased picture of relative fiscal capacities, unless the sources excluded were uniformly distributed across all provinces.
- **Representative.** To be representative, the RTS would use definitions of tax bases that reflect closely the tax structure actually used by the provinces. This is based on the premise that the RTS reflects what governments actually do.

- **Appropriately categorized.** To be appropriately categorized, all the items in the RTS that make up a category, or revenue source, would have common characteristics and the ability to be taxed at similar rates.
- **Accurate.** To be a reliable measure of the tax base, the data used to measure the various tax bases must be as accurate as possible.

8.47 These criteria emerged from our review of documents and discussions with officials. While the Department currently uses such criteria for its assessment of the RTS, nowhere are they explicitly set out.

8.48 The Department of Finance should formalize a set of principles to guide its review of the Representative Tax System.

Department's response: The criteria that the Auditor General has outlined above are used by the Department to guide its review of the RTS.

8.49 To review the Department's efforts to keep the RTS consistent with the foregoing criteria, we selected five revenue sources — sales taxes, lottery revenues, resource taxes, property taxes and user fees — which demonstrate how the revenue bases can change and the need to keep them constantly under review.

8.50 We briefly discuss the first three, but focus more on property taxes and on user fees. Our findings are based on a review of departmental files as well as discussion with both federal and provincial officials.

8.51 The Department has already flagged two of these sources — sales taxes and lottery revenues — where changes might have to be made for the 1999 program renewal. Resource taxes and property taxes are also open for discussion, but user fees are not part of the current federal–provincial discussions for the 1999 renewal.

Treatment of sales taxes and lottery revenues in the representative tax system

8.52 Sales taxes. Sales taxes represent an area where the base used in the RTS may no longer be representative of the tax structure used by all the provinces.

8.53 As a result of an agreement they reached in early 1996 with the federal government, Nova Scotia, New Brunswick and Newfoundland will replace their current sales tax systems with a value-added tax beginning 1 April 1997. The new tax will have the same base as the federal GST, and these two taxes together will be administered as a single tax called the Harmonized Sales Tax (HST). The rate for the combined federal–provincial tax was set at 15 percent. Quebec already uses a GST base for its general sales tax. This change means that four provinces who account for about a third of Canada's total population will be using a common sales tax base that is significantly different from the one currently used in the RTS.

8.54 Because the RTS is intended to be consistent with the principle that tax bases reflect the tax structure used by the provinces, there is a need to review the way the sales tax base is currently measured. This means deciding whether there is a large enough proportion of the provinces using the GST base to warrant a change in the existing RTS base.

8.55 Lottery revenues. Lottery revenues are another area in which the practices of the provinces in the last few years have changed to a point where the current RTS may no longer be appropriate.

8.56 Lottery revenues have been treated as a separate revenue source in the RTS since 1977, with gross revenues from the sale of lottery tickets constituting the lottery base.

8.57 This arrangement worked well in the 1970s and 1980s, when most provincial lottery operations were similar. In recent years, however, the provincial gaming sector has been significantly transformed. In addition to selling conventional lottery tickets, provinces today are also operating video games, casinos, bingo, break–open tickets (instant tickets, a portion of which can be removed to reveal whether the player has won a prize) and other games of chance. The existing RTS base for lottery revenues does not cover most of these newer gaming activities. Revenues from these newer forms of gaming are treated differently for equalization purposes, depending on how they are organized in the various provinces. For example, where a casino is operated by a provincial lottery corporation, profits generated by the casino are equalized under the lottery revenues source. However, if the casino is operated by a government department, the *gross revenues* of the casino are equalized under the miscellaneous revenue source in the RTS. Similar inequities arise in the treatment of revenues from other games.

8.58 The way lottery revenues are captured in the RTS is another illustration of how the RTS can become less representative of the provincial taxing policies if it is not regularly reviewed and updated.

8.59 The Department is aware of the need to update the way sales taxes and lottery revenues are currently captured and is consulting with the provinces to do that.

Need to address provincial concerns about treatment of resource revenues

8.60 **Resource taxation.** Resource taxation is a tax area where the ground is always shifting, and illustrates why the RTS must be continually reviewed to keep it as optimal as possible.

8.61 The resource revenue bases in the RTS are measured on the basis of value or volume of production. Ideally, they would be measured on the basis of “economic rent”, or the value of a resource over its cost of production (including a normal rate of return on the associated investments). Rent is the true measure of taxable potential, since by definition it consists of value that can be taxed without affecting production. Because natural resources in different locations can differ significantly in quality and production costs, rents associated with them can also differ significantly. These differences are not necessarily captured by the value or volume of production. The existing RTS formula tries to correct for this in part by breaking down resources into separate categories according to their expected proportions of economic rent. Thus, there are separate sources for new oil, old oil, heavy oil and mined oil.

8.62 Still, conditions in petroleum markets are under continuous change, as are technologies and methods of extracting oil. Existing classifications of revenue sources and bases for oil can rapidly become outdated. For example, Saskatchewan argues that the current equalization formula lumps together oil sources with much different profit potentials. The resulting national average tax rate (per barrel of oil produced) overstates the extent to which the low–profit oil can be taxed. Royalties generated from low–profit oil may not be sufficient to compensate for the loss in equalization payments associated with production of that oil. In other words, production of such oil may cause a province to lose more in equalization transfers than it gains in oil revenues.

8.63 Quebec has expressed similar concerns about the base for forestry revenues. Forestry revenues include income from logging, plus royalties, licenses, rentals or fees related to the exploitation of forestry resources. The tax base used in the RTS for forestry revenues is cubic metres of wood cut in Crown lands, as reported by Statistics Canada. Quebec argues that trees are not a homogeneous product; spruce grown in Quebec is not equivalent in value to the cedar grown in British Columbia. Since the revenue yield of forestry products is related more to the value than the volume of production, the current RTS base for forestry revenues may exaggerate the fiscal capacity of Quebec and other provinces with large volumes of relatively low–value wood products.

8.64 The federal government is aware of provincial concerns about the way resource revenues are covered in the RTS and of the need to remain consistent with the principle that revenue sources be appropriately categorized.

8.65 The Department of Finance should continue to review resource taxes in the Representative Tax System to determine whether it can find a way to accommodate provincial concerns in this area, while remaining consistent with the principle that revenue sources like resource taxation be appropriately categorized.

Department's Response: The Department expects to address this issue as part of the current Equalization renewal process.

Need to review the current property tax base

8.66 **Property taxes.** Property tax is the revenue category that produces the second-largest amount of entitlements in the equalization program. In 1996-97, property taxes accounted for nearly \$2 billion, or 22 percent of total equalization payments. Only personal income taxes produce a larger amount.

8.67 Property taxes were not brought fully into the RTS until 1982. They had first been recognized as a separate revenue category in 1973, when municipal property taxes for school purposes were brought into the equalization formula. As the Economic Council of Canada said in a 1982 report, one reason municipal property taxes had been left out of equalization when the RTS was first adopted was "that there was no suitable measure available to determine the base for the real property tax."

8.68 The difficulties of finding a suitable base for the property tax have not diminished over the past three decades. They are conceptual as well as practical.

8.69 On the practical side, comparable data on real property values across (and even within) provinces have always been difficult to obtain. The problem stems from the nature of the property tax base, and more specifically from the fact that the base needs to be *assessed*, rather than observed. For most revenue sources, the tax base consists of the volume or value of transactions over a specified period. For the personal income tax, the tax base is the income earned by the taxpayer over the calendar year; for cigarettes, the base is the number of cigarettes sold; for natural gas, it is the volume of gas produced. In the case of real property, the base is a stock of non-homogeneous items, only a small portion of which changes hands each year. The value of the stock must therefore be estimated or assessed. Assessments inevitably involve judgment, and judgments can differ.

8.70 This inherent problem in the valuation of real property is further compounded by the fact that assessment practices differ from one class of property to another, from one province to another, and even from municipality to municipality. In addition, assessments are infrequent and use different base years, so that assessments are not comparable even within the same municipality. The government therefore lacks a common measure of property values that would allow for interprovincial comparisons.

8.71 On the conceptual side, there is no agreement on the appropriate base for taxing property. In most provinces, legislation requires that real property be assessed at its market value. If the practical difficulties were resolved, that is, if more reliable and uniform assessment practices existed across Canada, market value could provide a common standard for property values among provinces.

8.72 In the past, however, the federal Department of Finance has rejected the use of market value as the property tax base because it is not satisfied that market assessment is the appropriate base for measuring the capacity to tax real property. Even where market value assessments exist, the Department argues, municipalities do not have common standards for taxing properties. In addition, market values are volatile, primarily because of fluctuating land prices. Thus, changes in market values do not necessarily reflect changes in fiscal capacity.

8.73 The current property tax base measures relative fiscal capacity with an estimate derived from the value of buildings combined with proxies for the value of residential, commercial and agricultural land. These proxies take

into account differences in income and in urban density. The intention of the measure is to approximate the value embodied in property that authorities can actually tax.

8.74 Whether it actually does this, however, is in dispute. Some provinces argue that, to a considerable degree, the weights used in the formula to distribute property values across provinces are arbitrary, and that the formula is not sufficiently sensitive to changes in property values. Moreover, the formula does not seem consistent with the basic RTS principle that the tax sources used should closely represent what provinces actually tax. No province levies property taxes on the basis used in the equalization program. The property tax base in every province is the assessed value of the property, normally based on market values.

8.75 The development of an appropriate property tax base in the RTS has absorbed much time and effort of federal and provincial officials over many years. In more recent years the efforts of the Department have focussed on fine-tuning the weights in the proxy base. We believe that work on the property tax base needs to continue, but with greater emphasis on developing a base that is more representative of provincial practices in this area.

8.76 Recent developments in provincial policies for property tax assessment suggest that the practical difficulties may be less daunting in the future. Earlier this year, Ontario (which accounts for nearly half of the property tax base) announced that, beginning in 1998, it will adopt a province-wide system that assesses properties at market value in a common base year and regularly updates assessments thereafter. A similar system is already used in British Columbia.

8.77 **The Department of Finance, in consultation with the provinces, should review the current property tax base in the equalization formula to determine whether it reflects provincial capacities to generate revenues from this source.**

Department's response: The Department expects to address this issue as part of the current Equalization renewal process.

A need to re-examine the treatment of user fees

8.78 A user fee is the money directly collected from individuals, households and business entities for goods and services they receive from government. Examples include water and sewer charges, transit fees, tolls for the use of roads or bridges, and fees for the use of parks, swimming pools, libraries and other public facilities.

8.79 With public debts at record high levels and public tolerance for tax increases extremely low, governments at every level are resorting to alternative revenue sources such as user fees to meet their financial needs. Provincial and local government receipts from the sale of goods and services doubled from \$6 billion in 1984 to \$12 billion in 1994. How these revenues are treated in the equalization formula can have a significant effect on overall equalization payments and the entitlements accruing to the receiving provinces.

8.80 User fees imposed by the provincial governments have been part of the equalization formula since the introduction of the RTS in 1967. Similar fees imposed by municipalities were brought in with the 1982 renewal. Currently, they are included under the "miscellaneous" revenue category of the RTS.

8.81 The base for user fees consists of total revenues generated from all the sources in the RTS except resource revenues. In other words, the relative capacities of provinces to raise revenues through user fees are assumed to be the same as their relative abilities to raise all non-resource revenues.

8.82 **Should user fees be included in the RTS?** Arguments can be marshalled on either side of this question. The case for including them rests principally on their similarity to ordinary taxes. According to this view, the way

provincial governments raise revenues, as distinct from how much they raise, should not have a bearing on equalization entitlements.

8.83 Also supporting their inclusion is the argument that leaving them out could distort provincial fiscal policies. That is, equalizing taxes and not user fees provides a fiscal incentive for provinces who receive equalization payments to raise revenues by taxation rather than by charging user fees.

8.84 The case against equalizing user fees emphasizes their similarity to prices charged in private markets. Like commercial prices, user fees represent compensation to providers of goods or services. Taxes, by contrast, are payments to government, for which no service is provided directly in return.

8.85 The distinction entails more than a mere semantic difference. The purpose of equalization payments is to enable provinces to provide “reasonably comparable levels of public services at reasonably comparable levels of taxation.” To the extent that users of government–provided goods and services pay for them, the capacity to provide such goods and services is directly related to the demand for them. In other words, the users of a “user pays” service also generate the capacity to provide the service. Hence, according to this view, there is no need to equalize that capacity. Governments need revenues only for those services that they want to provide free or to subsidize: it is that capacity that needs to be supported.

8.86 Looking at this question another way, fees used to finance “user pays” activities are not available to finance general government services. There is no revenue source, as such, to equalize. This view holds that the revenue sources that ought to be equalized are those used to finance what have been viewed traditionally as public services, namely, services for which the public does not pay directly.

8.87 The same conclusion can be reached by proceeding from some basic principles underlying fiscal equalization. Equalization payments exist because provinces differ in their fiscal capacities — their ability to raise revenues to provide public services. In the absence of equalization payments, these interprovincial fiscal differences would lead to different fiscal treatment of individual Canadians, depending on their province of residence, because wealthier provinces would be able to provide more services than poorer provinces with the same level of taxation. Equalization payments help reduce these differences.

8.88 However, differences in the fiscal treatment of individuals across provinces can arise only to the extent that there are differences between the taxes individuals pay and the benefits they receive. If there were no difference, as is the case when the service is paid for by an appropriate fee, there would be no need for transfers aimed at equalizing differences.

8.89 **The Department of Finance should** re–examine the present treatment of user fees to determine whether it is consistent with a comprehensive Representative Tax System and is therefore an appropriate revenue source to be included in the equalization program.

Department’s response: The Department will raise this issue with provinces as part of the current Equalization renewal process.

Maintaining a Program That Is Sustainable for the Federal Government

8.90 As we have noted, the government has established a number of secondary objectives, and constraints, that are important in the overall delivery of the program.

Choosing the base year for the ceiling

8.91 Sustainability and the ceiling. How much the federal government can afford is very much a political question that deals with choices it must make between one program and another. However, once a decision has been made to establish a ceiling, the nature and use of the government's criteria for implementing it is an audit issue.

8.92 Since 1982, the equalization formula's ceiling provision has limited the cumulative growth of total equalization payments to the cumulative growth of GNP from a base year, currently 1992. If the growth of equalization entitlements from the base year to any fiscal year exceeds the growth of GNP over the same period, entitlements are scaled back to the level of growth in the GNP. The ceiling came into play for three years, 1988-89 to 1990-91, as a result of very strong economic growth in Ontario over that period, and did so again in 1993-94.

8.93 When the ceiling comes into play, entitlements to all receiving provinces are scaled back on an equal per capita basis. This lowers their per capita transfers from the amount that the five-province standard would have generated had the ceiling not been in place. The effect of the ceiling, therefore, is to lower the equalization standard. The impact is greatest on the receiving provinces whose revenues are closest to the standard (currently Quebec and Saskatchewan), because their per capita entitlements are smaller than those of the other receiving provinces yet their reduction on a per capita basis is the same.

8.94 When the ceiling was first introduced in 1982, there had been considerable growth and volatility in equalization entitlements. The ceiling, along with the change to the five-province standard introduced at the same time, was a means of protecting the federal government against sharp increases in payments (as had frequently occurred in the 1970s) without mid-period revisions to the formula.

8.95 The base-year for the ceiling was changed in each of the three renewals of the equalization program after 1982, except for the most recent renewal in 1994. Each time, the effect of the change was to lower the ceiling. Specifically, as shown in Exhibit 8.4, the ceiling fell from 1.34 percent of GNP in 1982 to 1.24 percent of GNP in 1987 to 1.17 percent in 1992.

Exhibit 8.4

(This exhibit is not available, see the Report)

8.96 While recipient provinces have complained that these reductions reflect deliberate efforts by the federal government to reduce its own financial burden, our review suggests that the ceiling reductions were probably incidental rather than by design. In each renewal of the ceiling, except for the 1994 renewal, the year chosen as the base was the first year of the next equalization period. Since the government could not know with any certainty what the equalization payout would be for that year in relation to the size of the economy, it could not know how stringent, or how generous, the ceiling would turn out to be. In other words, this way of proceeding leaves the federal government with no protection in the initial year and with an unknown degree of protection in subsequent years.

8.97 We raise this matter because there seems to be no framework or rationale to guide Finance in deciding on a base year for the ceiling. The result is that neither the federal government nor the provinces can assess the impact of any change until after it is introduced. If a set of principles were established for deciding how and whether to change the base of the ceiling, it would be easier for both levels of government to assess its impact in advance, and would therefore assist them in their budget planning.

8.98 **On the premise that the GNP-based ceiling continues into the next renewal period, the Department of Finance should identify a set of principles for choosing an appropriate base year for the equalization ceiling and use those principles in subsequent renewals.**

Department's response: The Department expects to address the design of the ceiling as part of the current Equalization renewal process.

Maintaining a Program That Provides Stability for the Provinces

Application of the “floor” provision

8.99 Stability and the floor provision. To balance the ceiling, a floor was also introduced in 1982 to ensure that each province receiving equalization payments would not suffer a year-over-year reduction of more than 5, 10 or 15 percent, depending on its revenue-raising capacity. The 95 percent floor applies to provinces whose fiscal capacity is below 70 percent of the national average (Newfoundland and Prince Edward Island at present). The 90 percent floor applies to provinces whose fiscal capacity is 70 to 75 percent of the national average (New Brunswick). And the 85 percent floor applies to provinces with a fiscal capacity greater than 75 percent of the average (Nova Scotia, Manitoba, Saskatchewan and Quebec). The floor thus provides greater protection to provinces whose fiscal capacity before equalization is lowest.

8.100 A feature of the existing floor provisions that is of particular concern to the recipient provinces is that a small change in a province's estimated fiscal capacity can result in significant changes to its entitlements by moving the province into a level with a different floor protection.

8.101 To illustrate, in October 1994 the fiscal capacity of New Brunswick for 1992-93 was estimated at 75.12 percent of the national average, up from 74.22 percent in March 1994. As a result, the associated level of protection fell from 90 percent to 85 percent, lowering the payments to the province by \$48.3 million for fiscal year 1992-93. In March 1995, New Brunswick's fiscal capacity was re-estimated at 74.96 percent, thereby increasing its entitlement again by \$48.3 million. Similar swings have been experienced in the past by Saskatchewan and Prince Edward Island.

8.102 As with the ceiling, we raise this issue because the way the floor provision works makes it difficult for provinces close to one of the floor levels to plan their budgets, since their transfers can move up and down significantly until a payment year is finalized.

8.103 The Department of Finance should review the equalization floor to even out its protection to recipient provinces.

Department's response: The Department expects to discuss the mechanics of the Equalization floor during the current renewal process.

Remaining Accountable

8.104 The equalization program is a federally legislated program for which the Department of Finance is accountable to Parliament. This means that Parliament can expect the following from the Department:

- a clear statement of the objectives of the program;
- clear performance expectations; and
- credible and reasonable reporting of results.

Accountability to Parliament for the program

8.105 On an annual basis, little information is regularly provided to Parliament on the workings of the equalization program other than through the annual appropriations process and the Public Accounts. The Department of Finance's Part IIIs have not reported to Parliament on the way the program works or on its performance. Nor is there any indication provided as to where parliamentarians can obtain such information.

8.106 For the five-year cyclical renewal of the program, Parliament is presented with legislative proposals anytime from a few months to a few weeks before approval is required.

8.107 There are precedents for involving Parliament before the program's renewal; an example is the *Bank Act*. Legislative proposals are preceded by a white paper, which is presented with enough time for parliamentarians, in committee, to seek input from concerned Canadians about the proposed changes.

8.108 Equalization legislation, however, is different from the *Bank Act* because of the provincial dimension. Because of that, much of the discussion on revisions to the program is part of a process often referred to as "executive federalism", in which federal and provincial officials engage in discussions behind closed doors. We are concerned that those to whom the government is ultimately accountable are often left out of the deliberations until well after federal and provincial officials and the ministers involved have agreed to the terms of the revisions.

8.109 We believe that the process needs to be opened up to facilitate wider participation in the consideration of changes to such a fundamental program. Many interested parties, including some leading academics, have given considerable thought to this program and we believe their views could be useful. The government tried this approach once, in 1981, when it established the Parliamentary Task Force on Federal-Provincial Arrangements (Breau Committee), which focussed on all fiscal transfers including equalization. Its report, *Fiscal Federalism in Canada*, stands today as one of the best public assessments of Canada's fiscal situation.

8.110 Whether there is a full review of fiscal federalism such as the Breau Committee's, say every 10 years, or more effective involvement of Parliament in reviewing equalization every five years, is up to the government. Parliamentarians could be consulted after federal and provincial officials have finalized their work on proposals for program change and before federal and provincial finance ministers meet. In any case Parliament, which has to authorize this program, needs to be consulted and, through the committee process, could be an effective instrument in shaping a federal program like equalization.

8.111 **The Department of Finance should ensure that Parliament is consulted in a meaningful way on the periodic renewal of equalization.**

Department's response: The Department is prepared to respond to any request from Parliament in this regard.

Relationship with the provinces

8.112 Twice a year, the federal government provides the provinces with booklets that show the detailed calculations behind the equalization payments. They also inform the provinces of any issues that could affect changes in the payments, such as:

- tax bases;
- population adjustments; and

- changes to the Financial Management Series (the database maintained by Statistics Canada from which revenue information for the program is obtained).

8.113 Also, there are regular meetings of a committee on federal–provincial fiscal arrangements, chaired by the Assistant Deputy Minister of the Federal–Provincial Relations Division of the federal Department of Finance. In addition, there is a permanent subcommittee on equalization that begins its intensive review of the program approximately two and a half years before each renewal of the *Federal–Provincial Fiscal Arrangements Act*. This process, according to the Department of Finance, is the major vehicle for assessing the program.

8.114 In one sense, this is an effective way to review a program such as this, because it is done on a regular basis and involves more than the officials who run the program. But it does have two shortcomings, in our opinion.

8.115 The first is that it is a closed process with no mechanism to inform legislators at either the federal or provincial level, or any other interested observers, about the subjects discussed or the outcomes of the review.

8.116 The second shortcoming is the limited time frame normally allowed for the review process. At the beginning of every new five–year period, there are outstanding issues from the previous period that have to wait for two and a half years to be considered again. In our review of the RTS, we identified at least two issues that have been pending since long before the last renewal: resource taxes and property taxes. Federal and provincial officials are well aware that these are difficult issues to resolve and in the fall of 1996, when the equalization subcommittee began its intensive work leading to the 1999 renewal, these same two issues were put on the table again.

8.117 In our opinion, these unresolved issues ought to have been addressed immediately after the last renewal instead of waiting two and a half years to be considered again.

8.118 A more timely review of the program by officials would also better accommodate the need for a more meaningful consultation of Parliament: the sooner the federal–provincial review process is completed, the more time the federal Parliament can have to consider the results of the process prior to each periodic renewal.

8.119 **The Department of Finance, through the federal–provincial equalization subcommittee, should deal with outstanding equalization issues on an ongoing basis.**

Department's response: The Department's view is that outstanding issues are being addressed by the Equalization subcommittee on an ongoing basis.

Administration of the Program

8.120 We expected to find that the Department of Finance would have a means to ensure that equalization entitlements are appropriately calculated and paid in accordance with relevant legislation and regulations, and the process managed with due regard to economy and efficiency.

8.121 We reviewed the results of our annual financial audits of the equalization program to help us determine whether these criteria are being met. We also looked at issues surrounding the number of equalization entitlement calculations, the underlying data and the treatment of underpayments and overpayments.

8.122 We carry out annual audit work on the equalization program as part of our audit of the Summary Financial Statements, which are published in the Public Accounts. Our work in this area found that entitlements and payments are calculated correctly, using the required data, and are made in accordance with the *Federal–Provincial Fiscal Arrangements Act* and the regulations. We also noted that overpayments to provinces are properly accounted for and collected in accordance with the Act and the regulations.

Calculating the equalization entitlement

8.123 The regulations provide specific instructions on the number and timing of equalization entitlement calculations. Essentially, there are eight entitlement calculations for each equalization year, starting with an initial estimate just prior to the start of the fiscal year. The final equalization calculation is generally made 30 months after the end of the fiscal year, because the data used in the calculation are not finalized until then.

8.124 In the early 1990s the Department established a standard calculation schedule to improve administrative efficiency. Calculations are now made twice a year, in October and February, with all open fiscal years (those not yet finalized) calculated at the same time. Each set of entitlement calculations is prepared by three people over a one-month period.

8.125 We analyzed the variability of equalization entitlement estimates from the initial estimate to the final calculation for the fiscal years 1987-88 to 1995-96. Exhibit 8.5 shows the variability in the program as a whole. The exhibit shows that each interim calculation tends to move the estimate closer to the final amount, though from the fifth estimate to the eighth and final estimate there was little percentage difference. At the provincial level the trend was the same but there was a greater degree of variability, particularly in the provinces close to the equalization standard.

Exhibit 8.5

(This exhibit is not available, see the Report)

8.126 The receiving provinces use the entitlement information for provincial budget planning and for ministerial briefings. Consequently, they would like to receive more frequent calculations. At the same time, the variability analysis indicates that the number of calculations could be reduced. However, given the small preparation cost to the Department, the current calculation schedule appears to be a reasonable compromise between provincial needs for information and the Department's need for administrative efficiency.

Reasonableness of the data

8.127 The underlying data used for the final calculation of equalization entitlements come from a certificate prepared by the Chief Statistician of Canada. Until it receives this certificate, Finance uses estimates of revenue and base data that come from a number of sources, principally the provinces (revenue) and Statistics Canada (base data).

8.128 Provincial revenue estimates are reviewed by the Department of Finance for reasonableness. Finance analysts monitor changes in provincial budgets and tax policy. The estimates are compared with previous years, and significant differences not accounted for by changes in budget and policy are followed up with the provinces.

8.129 Finance uses the latest available data for determining tax bases. These data come either from the latest mini-certificate, an interim document provided by Statistics Canada, or from other more recent sources. Finance reviews the mini-certificate and other data for reasonableness. Data used for the final certificate are also reviewed for reasonableness. Any changes to the final certificate are made through letters of amendment prepared by Statistics Canada.

8.130 The provinces also receive copies of the entitlement calculations, including details of the underlying data. While there is no formal requirement that they review the data, the provinces will normally contact the Department or Statistics Canada if they note unusual items.

Asymmetrical treatment of underpayments and overpayments

8.131 We found no evidence to indicate a systemic bias in the calculation of entitlement estimates. Calculations are based on the latest available information, which means that overpayments can occur as easily as underpayments.

8.132 The regulations stipulate the way Finance must deal with adjustments resulting from revised calculations of entitlements. These depend on when an entitlement calculation is made. Other programs that form part of federal–provincial fiscal arrangements, such as the Tax Collection Agreements, may have an impact on the way equalization adjustments are handled. For example, an overpayment in one program may be permitted to be offset against underpayments in another program.

8.133 In general, adjustments to the current year’s equalization entitlements made as a result of revised calculations before the end of the fiscal year are handled by increasing or decreasing the remaining payment stream in that fiscal year. Subsequent adjustments resulting from revised entitlement calculations are handled differently, depending on whether the adjustment identifies an underpayment or an overpayment.

8.134 Underpayments are generally made up to the province immediately. Overpayments, however, are generally repaid by the provinces in equal monthly installments over the remaining months in the fiscal year (estimates made in October), or in equal monthly installments in the succeeding fiscal year (estimates made in February). The amount of overpayment to be recovered is subject to per capita limits and there are also special rules for overpayments related to census coverage adjustments.

8.135 The current treatment is asymmetrical, given that the federal government pays the provinces immediately for underpayments whereas provinces have the option of repaying an overpayment over an extended period — up to a year for normal overpayments, and a minimum of five years for the 1991 census adjustments. These overpayments are treated as non–interest–bearing loans to the provinces. The total amounts of such loans to the provinces may also include overpayments related to other financial programs such as the Tax Collection Agreements, Fiscal Stabilization and Revenue Guarantees.

8.136 Exhibit 8.6 indicates the outstanding amount of equalization– related loans to the provinces since 1983-84. The increase in balances from 1992-93 onward occurred largely as a result of census adjustments.

Exhibit 8.6

(This exhibit is not available, see the Report)

8.137 Provinces are advanced money by the federal government on a “good faith” basis, using the best available data at the time the estimate is made. Furthermore, because the potential impact of subsequent adjustments is not known at that time, it would be unreasonable to expect the provinces to put aside some of the equalization funds they receive in case they have been overpaid. Allowing provinces to repay unexpected overpayments over a period of months helps provincial cash flows.

8.138 However, there is an implicit cost to the federal government represented by the interest cost of carrying additional debt. To illustrate, we estimate that the additional interest cost to the federal government to carry the outstanding loan balance during 1995-96 was approximately \$38 million. This calculation takes into account recoveries during the year and uses the average interest rate on federal debt in 1995-96 of 7.34 percent.

8.139 This additional benefit to the provinces of the free use of federal funds is not necessarily shared equally by all of the receiving provinces. In any particular fiscal year, some provinces may have been overpaid while others may have been underpaid. The provinces that have been underpaid do not get the free use of federal funds. In fact, in preparing their fiscal plans these provinces, through own source methods, have likely had to adjust for the lower amounts received on an interim basis and have incurred their own costs, since the federal government does not pay interest on underpayments.

8.140 While the current process may be easier to manage administratively, there are built-in inequities, both between the federal and provincial governments and among provinces.

8.141 Any review of this process would have to take into account that, while this is a federal program, it has significant implications for the provincial governments. Discussions would need to look at the impact on not only the federal government but also the provincial governments. In addition, the impact on the other financial programs that are included in loans to the provinces would have to be considered.

8.142 One method of reducing these inequities would be to recognize the carrying costs of these loans by applying interest charges to both underpayments and outstanding overpayments.

8.143 **The Department of Finance, in conjunction with the provinces, should review the asymmetrical treatment of overpayments and underpayments and determine whether interest should be paid on such balances, keeping in mind the impact on other financial programs.**

Department's response: The Department expects to address this issue as part of the current Equalization renewal process.

Conclusion

8.144 The equalization program is a dynamic program that requires continuous attention and refinement. With its primary objective of ensuring that provinces have the fiscal capacity to provide reasonably comparable levels of public services at reasonably comparable levels of taxation, the only certainty about the program is that it has to change if it is to keep up with the constantly evolving systems of taxation that run across provincial and municipal jurisdictions in Canada.

8.145 The conclusions of this audit are consistent with the *Report of the Royal Commission on the Economic Union and Development Prospects for Canada*:

...equalization is a vital feature of the Canadian federation. While there are many reasons to be proud of what Canadians have achieved in this area, there is room for improvement.

8.146 In the wisdom of those who initiated the program, there is a requirement that the program be re-enacted every five years. This gives the program recipients (provinces), the administrators (federal government), and the legislators (Parliament) the regular opportunity to assess the program's performance in a meaningful and open way to ensure that it continues to contribute to the social fabric of Canada. It was in the context of this continued need for a meaningful, open assessment to keep the program current that we conducted this audit.

8.147 Indeed, for 40 years the equalization program has been one of the mainstays in contributing to the principle that all Canadians should have access to reasonably comparable levels of public service at reasonably comparable levels of taxation. Virtually all who have looked at this program, ranging from parliamentary committees to royal commissions, have pronounced it one of the main successes of the federation.

8.148 Our assessment was no different. We found a program that, on the whole, is well managed. We also found that the Department of Finance takes good advantage of the five-year review process to ensure that the program evolves for the better. Nevertheless, we did identify some areas where we believe improvements could be made, particularly as the Department undertakes the current review leading up to the 1999 renewal.

8.149 Finally, we believe that the Department of Finance ought to devote more effort to its relationship with Parliament. Parliament is the legislator for this program and the body to whom the Department and Minister are accountable. In our view, this relationship could be used to the advantage of the Department and for the betterment of the program.

About the Audit

Scope

The audit focussed on the operations of the equalization program, which is delivered by the Department of Finance. We did not look at this program in the context of other transfers to the provinces, specifically the Canada Health and Social Transfer program.

Objectives

The objective of this chapter is to explain to parliamentarians and to Canadians in general how the program works, and to report the findings of our comprehensive audit, which looked at compliance with all relevant authorities, financial management and controls, and value for money.

The first two components of this audit — compliance and financial management and controls — were begun in conjunction with the audit of the Summary Financial Statements of the Government of Canada. The audit was extended to cover the frequency of entitlement calculations, the reasonableness of the data, and the asymmetry between overpayments and underpayments.

For the value-for-money component of the audit, we focussed on two activities:

- the efforts of the Department to assess the program's performance and make adjustments when appropriate; and
- the efforts of the Department to keep Parliament informed about the way program operates and its performance.

Methodology

In auditing the Representative Tax System, we did not audit all 33 revenue sources. Rather, we selected five key revenue sources — sales taxes, lottery revenues, resource taxes, property taxes and user fees — all of which demonstrate how the revenue bases can change and the need to keep them constantly under review.

Audit Team

David Willey
Basil Zafiriou
Paul Zind

For information, please contact Jeff Greenberg, the responsible auditor.

Chapter 9

Foreign Affairs and International Trade Canada — Financial Management and Control

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Foreign Affairs and International Trade Canada — Financial Management and Control

Assistant Auditor General: David Rattray

Responsible Auditor: John Hitchinson

Main Points

9.1 Since our 1994 audit, Foreign Affairs and International Trade has continued to improve financial control in areas where problems had previously been identified, specifically the collection of rent from employees and control of money advanced to employees. Financial training has also been improved. While progress has been made in improving basic financial systems, more remains to be done, and an attitude of cost awareness and stewardship needs to continue to be encouraged throughout the Department.

9.2 The \$25 fee added to the cost of each passport issued for recovery of consular costs was based initially on incorrect cost information. Subsequent to our audit, the Department undertook a new calculation of costs. Although this recalculation identified a number of cost increases and decreases, no adjustment to the consular fee appears necessary.

9.3 The Bureau of Physical Resources has introduced a more businesslike approach to managing property in the Department. However, in some areas control over spending on property maintenance remains weak. Large amounts have been spent on renovating and repairing official residences when heads of mission changed, without the missions and the Bureau together clearly establishing the requirements. The Bureau has not developed an overall financial plan for senior management review that presents likely annual expenditures and revenues, and alternative funding strategies for dealing with the uncertainties inherent in capital projects abroad. Information systems do not yet adequately support the property management function.

9.4 The Department has achieved global desk-to-desk communications with the implementation of its Secure Integrated Global Network (SIGNET); however, it has proved to be a greater task than originally envisioned. A new Chief Information Officer (CIO) has been established to be accountable for consolidating the plans and budgets for all information technology expenditures in the Department and recommending priorities. The financial information system was not used in a consistent way for budgeting IT expenditures across the Department.

9.5 The Foreign Service Directives (FSDs) have not changed since our last audit. However, recent initiatives to review these directives from the perspectives of tax, complexity and appropriateness could simplify the FSDs. The Department's ability to analyze and provide information on FSD costs has improved; however, the shared management structure for FSDs is not functioning as effectively as it could. The management of travel under the Foreign Service Directives has improved over the past two years.

Introduction

Mandate of the Department

9.6 The mandate of Foreign Affairs and International Trade Canada can be summarized as the conduct of Canada's international relations, the promotion of international trade and the provision of assistance to Canadians abroad.

9.7 In the government's Foreign Policy Statement of February 1995, three key objectives were set for foreign policy:

- the promotion of prosperity and employment;
- the protection of Canada's security, within a stable global framework; and
- the projection of Canadian values and culture.

Organization

9.8 The Department has two ministers: one for Foreign Affairs and one for International Trade. It also has two Secretaries of State: one for the Asia-Pacific region and one for Latin America and Africa. A departmental organization chart is shown in Exhibit 9.1.

Exhibit 9.1

(This exhibit is not available, see the Report)

9.9 The Department represents Canada abroad through a network of 129 missions and 33 offices in 107 countries. Departmental headquarters is in Ottawa. In addition to its own programs, the Department provides administrative and operational support to other departments that have programs abroad, such as the Canadian International Development Agency, Citizenship and Immigration Canada, and National Defence.

Departmental resources

9.10 The Department's Main Estimates for 1996-97 provide for expenditures totalling \$1,377 million. The Department's expenditures reached a peak of \$1,565 million in 1994-95. Since then, expenditures have declined to \$1,356 million in 1995-96.

9.11 The major components of the Department's expenditures in 1995-96 were personnel-related expenses, transfer payments and other expenditures (see Exhibit 9.2). Personnel-related expenses are primarily salaries and payments under the Foreign Service Directives. Transfer payments are largely membership payments to international organizations, such as assessed shares for UN peacekeeping operations. Other expenditures include mission operating costs, capital expenditures, transportation and communications.

Exhibit 9.2

(This exhibit is not available, see the Report)

9.12 The Department employed 7,759 full-time equivalents (FTEs) in 1995-96, excluding those of the Passport Office. Of these, 2,410 (31 percent) were located at headquarters, and 5,349 (69 percent) were abroad. The

Department has a total of 1,024 Canada-based staff and 4,325 locally engaged staff working at missions abroad (see Exhibit 9.3).

Exhibit 9.3

(This exhibit is not available, see the Report)

9.13 Other government departments employ a further 538 Canada-based staff abroad, bringing the total number of Canadian government employees working abroad to 5,887. Of these, 1,740 are working on the programs of Foreign Affairs, 1,837 are working on the programs of other government departments, and 2,310 are employees of Foreign Affairs providing common support services.

Focus of the audit

9.14 The purpose of this audit was to examine whether the improvements we noted in our 1994 Report have been sustained since that time. Further details on the background and scope of our work are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

Financial Management

Some previously identified problems have been addressed

9.15 Shelter shares. The Department has improved its collection of shelter shares (rent from employees). In December 1995, the level of unpaid rent was substantially lower than the \$200,000 owing in December 1993. However, because the Foreign Service Directives still permit a number of payment options, shelter share collection remains complex. The Department has informed us that it plans to simplify collection by deducting centrally about 95 percent of shelter shares from foreign service allowance payments.

9.16 Accountable advances. Substantive improvements have been made in reducing the level of overdue advances to employees (see Exhibit 9.4). These improvements are largely a result of the Department's monitoring and vigorous collection efforts.

Exhibit 9.4

(This exhibit is not available, see the Report)

9.17 Comptrollership. Subsequent to our 1994 audit, the Department and the Treasury Board Secretariat undertook a study, conducted by Consulting and Audit Canada, of comptrollership in the Department. Several senior managers from the Department, the Treasury Board Secretariat and the Office of the Auditor General were interviewed for the study, and the findings and recommendations were reported in March 1995. The study made a number of recommendations for improving comptrollership in the Department, with an action plan covering six months, one year, and the longer term. The Department has acted on the recommendations and has focussed on ensuring that financial controls, such as those for travel claims, are functioning effectively. It improved financial training for heads of mission and increased the number of courses available to staff on financial matters. It is also establishing a departmental comptrollership council as a forum for discussion of issues related to financial management and control.

Year-end expenditure analysis is lacking

9.18 Under the current system, the Department's Executive Committee initially allocates budgets to functional and geographic bureaus, with any changes from the previous year well communicated. The geographic area managers then allocate budgets to missions according to historical levels. However, there has not been a comprehensive review of the levels for a number of years. Some incremental adjustments are made on a continuing basis, and others have been made concurrently with expenditure reduction exercises. A mid-year budget review exercise takes place with a view to preventing shortages or lapsing of funds at year end.

9.19 We examined the budgetary control exercised at headquarters and at missions. The Department has the accounting and management systems in place to ensure that budgets are not overspent. However, geographic area managers do not systematically analyze year-end results of expenditures by object, such as repair and maintenance, telecommunications and purchase of equipment, and compare them with original mission budgets for variances. As well, missions themselves often do not analyze their year-end results to explain variances with original budgets. One result is that budgets are unrealistic or contain errors that can go undetected. For example, one geographic area arbitrarily increased the budget of a mission by \$600,000 through a "technical adjustment". At the mid-term review, the mission decided to return the money, as it was not needed, nor had it been requested. We could find no documentation to explain the adjustment.

9.20 The Department is moving toward allocating its resources at the departmental level on a functional basis, according to its lines of business. Financial and information systems will have to be developed to support these lines of business so that costs are known and can be related to results achieved.

9.21 **Area managers and mission administrative officers should analyze year-end expenditures by object and explain significant variances. These analyses should be used in establishing subsequent budgets.**

Department's response: The Department supports this recommendation. Beginning with fiscal year 1996-97, the Department will ensure that significant variances in planned expenditures are reviewed at year's end. Processes appropriate to the new Planning, Reporting and Accountability Structure will be developed to relate these reviews to resource allocations.

The costing model has been improved and used

9.22 In our 1994 Report, we noted that Foreign Affairs and International Trade was developing a costing model for defining costs by program activity. The Department has made substantial progress in refining the model.

9.23 Although we did not conduct a detailed audit of its underlying methodology, the model has been generally accepted by senior departmental management as well as other government departments with operations abroad. Officials informed us that the model was useful during the departmental Program Review exercise, as it made visible the origins of a number of program activity costs that were not available from the financial system.

The recovery of consular costs was based on incorrect financial information

9.24 As part of meeting its Program Review targets, the Department obtained approval to recover the cost of providing consular services. In August 1995, the Department calculated an annual cost for consular services of \$48 million. Approximately \$12 million was to be recovered through various other charges. To recover the remaining costs of \$36 million, the Department established a \$25 consular fee that was added to the price of each passport issued. The \$36 million includes \$10.4 million made up of depreciation of buildings (\$1.7 million) and the borrowing cost of capital for buildings and land (\$8.7 million). Together, these amounts comprise 29 percent of the consular costs to be recovered.

9.25 The Department's calculations of depreciation and the borrowing cost of capital were based on a global estimate of the fair market value of its properties. This is not in accordance with the Treasury Board "Guide to the Costing of Outputs". Historical cost should have been used. The \$25 consular fee was proposed by the Department to the Treasury Board, which approved it in October 1995. In its analysis of the Department's proposal, the Treasury Board Secretariat did not address the issue of using a global estimate of fair market value as opposed to historical costs.

9.26 Departmental officials told us that fair market value was used because historical costs were not available. However, we found that in most cases, the Department did have some information on historical costs of properties. If departmental data on historical costs had been used as the basis for depreciation and borrowing cost of capital, the cost of properties would have been \$602 million rather than the \$3 billion estimated based on fair market value. The total cost of the consular program would then have been reduced by approximately \$9 million. This means the consular fee being charged to passport holders would have been about \$19, rather than \$25.

9.27 After we informed the Department of our findings, officials began an extensive recalculation of consular costs. This recalculation reduced the costs attributable to property. It also resulted in the identification of a number of other costs that should have been included initially, but were not. The Department's recalculations indicate that the net effect is that consular costs remain close to the original amount of \$36 million. The result is that no adjustment appears necessary to the consular fee. Although we could not audit the accuracy of each revision made by the Department, its revised approach to the identification of costs was more appropriate.

9.28 Accurate cost information is essential to sound managerial decision making. We are concerned that control over the initial identification of costs was inadequate, and resulted in the need for so many subsequent adjustments.

9.29 **The Department should validate the results of its costing exercises, particularly when these will be used in pricing decisions.**

Department's response: The Department agrees that accurate information is essential in establishing costs for pricing decisions. For that reason, it refined its costing model last year and submitted its methodology and output for external review. This year, it established a unit to conduct activity-based accounting. Finally, the Department has proposed to re-cost the consular program every year. This will be available for review by the Auditor General.

Continued improvements in cost awareness and stewardship are needed

9.30 In our 1994 audit, we commented on the need for more cost awareness and concern for public funds. We found several areas of improvement. At the missions, more emphasis is being given to financial management issues. The profile of the mission administrative officers (MAOs) has been raised, and help is available for MAOs who seek it. Program Review cuts have created an environment that focusses managerial attention on improving financial management and controlling costs.

9.31 In our work at missions, we saw instances where staff had taken action to reduce costs and manage resources more efficiently.

- In one mission, staff had implemented a computerized control system that automatically controls and monitors the physical plant of the chancery and automatically regulates climate control during silent hours. Staff estimate the savings in heating at about \$250 per day.
- A head of mission decided to reduce staff housing costs. The mission replaced and renegotiated several leases at an estimated annual saving of \$140,000.
- One employee combined business with personal travel to Canada using his vacation travel entitlement. This saved the travel costs that would otherwise have been incurred to conduct work in Canada.

9.32 However, there is still a need to reinforce an appreciation of costs and an attitude of stewardship in the Department. Following are some examples that illustrate this need.

- In one instance, not following normal purchasing practices because of insistence on ordering non-standard furniture resulted in an additional cost of \$22,900. The living room furniture was purchased for \$31,000, while available standard-issue furniture for representational purposes provided by headquarters was priced at \$8,100. This residence was used infrequently for hospitality.
- One mission had been retaining excess used furniture in leased warehouse space, at a cost of US \$3,500 per month. This furniture, with a total estimated market value of US \$1,000, would never again be useful to the mission.
- One mission leased a house for an employee that exceeded authorized space guidelines by 132 percent. Staff quarters closer to the guidelines were available on the market at a potential saving of almost \$37,000 per year. The head of mission informed us that the lease will not be renewed when the occupant leaves the mission.

Internal review continues to be active

9.33 In our 1994 Report, we stated that expanding the scope of internal audit work to include more significant aspects of headquarters activities and operational activities, such as international trade and political relations, would increase the overall effectiveness of the Office of the Inspector General.

9.34 The scope of internal review has since been expanded. While a number of mission inspections and audits will continue to be carried out, the focus of internal review has shifted toward headquarters activities. However, coverage of the areas of real property and information technology remains limited.

9.35 The Department's audit and evaluation committee provides direction and support to the Inspector General. This committee is chaired by the Deputy Minister for International Trade and meets semi-annually to approve the plans, priorities and performance of the Inspector General and identify issues for review. The committee is functioning well.

9.36 Internal review continues to be active. In 1995-96, the Inspector General carried out a number of mission audits, headquarters audits, evaluations and inspections, as well as several resource-focussed special studies as inputs to Program Review.

9.37 In addition to internal audit reports, the Inspector General also prepares inspection reports of missions. These differ from audit reports in that they are more subjective, and contain the Inspector General's personal evaluation of human resource management in a mission. For this reason, their distribution is usually more limited than that of audit reports.

9.38 Some inspection reports contain specific recommendations on areas where costs might be cut, or the functioning of mission activities improved. Because distribution of these reports is usually more limited, the follow-up of recommendations is not as systematic as for audit reports. Our concern is that opportunities to effect improvements might be missed.

9.39 **The Office of the Inspector General should implement a system to follow up and report on action taken on recommendations contained in inspection reports.**

Department's response: The Inspector General will report to the Department's Executive Committee from time to time on the extent to which his recommendations are implemented.

Property Management

The Bureau of Physical Resources has become more businesslike

9.40 The Department's total expenditures on property were approximately \$212 million in 1995-96. The Bureau of Physical Resources spent \$47 million on major construction and maintenance projects, and geographic bureaus and missions spent \$165 million to lease and maintain chanceries, official residences and staff quarters.

9.41 The Bureau shares responsibility for the management of property with the geographic bureaus and missions. Missions hold operating budgets for rental of properties and for minor maintenance, fit-up or renovation. They can also transfer funds from other spending objects or request additional funds from their geographic bureau. In addition, the Bureau holds a budget for major repairs and renovation as well as for new construction.

9.42 At the time of our audit in 1994, the Bureau of Physical Resources had just become a special operating agency (SOA). The purpose behind the change was to allow the Bureau to act in a more businesslike manner. In the past two years, the Bureau has made significant progress. For example, we found that it has:

- introduced Mission Property Management Plans. These plans provide key information concerning the management and use of property at each mission we visited. The plans are prepared by missions and, when current, they provide a basis for accountability discussions with the Bureau;
- disposed of approximately \$65 million in property since becoming a special operating agency;
- managed its cash flow by transferring some disposal revenues into later years to facilitate new construction;
- provided specialized training for its employees; and
- increased the rental revenue from excess space it holds. In 1994-95, the Department generated \$900,000 and increased revenues to approximately \$1,800,000 in 1996-97.

The Bureau needs an overall financial plan for property management in the Department

9.43 The Bureau's charter as a special operating agency (SOA) requires that it prepare annual financial plans. Capital spending (land, buildings) makes up the bulk of the Bureau's expenditures. The Bureau has developed a Long-Term Capital Plan that has served as the financial component of its Business Plan for capital spending. The Plan includes a prioritized list of projects to meet the Bureau's objectives, which are to provide economical, safe facilities that meet program needs. The Long-Term Capital Plan is used as a comprehensive list of needed projects and opportunities for disposals. We examined the Long-Term Capital Plan to see if it served as an adequate financial plan.

9.44 The Bureau faces numerous difficulties in realizing capital projects abroad. Obtaining permits, negotiating with contractors, and working through other governments can lead to delays and make project timing uncertain. Property values in many countries have also fallen, forcing the Bureau to reconsider the availability of funding from disposals. Between 1993-94 and 1995-96, spending by the Bureau amounted to only 40 percent of the potential expenditures identified in the Plan. However, the most recent Plan in October 1996 indicates that the Bureau projects that it will carry out capital spending totalling \$142 million in 1997-98.

9.45 The Department has been successful in disposing of many properties. Since becoming a special operating agency and to the end of our audit, the Bureau of Physical Resources has disposed of 115 properties worth \$65 million.

9.46 We found that most of the revenues generated from earlier disposals were not reinvested in the property portfolio. Of the \$65 million, the Bureau was not entitled to credit for government-directed disposals totalling \$25 million, initiated before the creation of the special operating agency. Subsequently, the Bureau initiated the disposal of about 90 properties worth approximately \$40 million. After repaying \$10 million to meet previous departmental commitments to deficit reduction, the Bureau retained approximately \$27 million to be used for property investment. In March 1995, the Treasury Board allowed the Department to retain 100 percent of disposal revenues, on condition that the revenues be reinvested in property. The Bureau considers the continuation of this arrangement vital, in light of the number and complexity of current and planned capital projects around the world. We believe that it provides the incentive, as well as an acceptable means, for portfolio management.

9.47 The Bureau has not achieved its short-term projections for revenue from disposals shown in the plan. The Bureau planned in 1993 to dispose of a large number of properties for revenues of \$19 million. Planned disposal revenues increased to \$21 million in 1994-95, and \$34 million in 1995-96. Its current plan projects revenues of almost \$36 million from disposals in fiscal year 1997-98. Actual revenues from disposals peaked at \$20 million in 1994-95 and have averaged \$11 million per year since 1993-94. Officials told us that the Department holds properties that could be sold, as a reserve against future needs. It sells properties when funds beyond its appropriation are required for new projects.

9.48 The shared responsibility for property management among the Bureau, geographic bureaus and heads of mission can complicate planned disposals. Conflicting objectives can arise, resulting in delays and additional costs.

- An example of such a complication occurred recently at one mission. In April 1996, the Treasury Board approved a Bureau initiative to sell the official residence at the mission and replace it with a leased property. The Bureau had plans to use the gross revenues of \$12 million to build needed facilities at other missions. A residence meeting departmental guidelines was leased for \$350,000 per year and renovations and furniture purchases totalling \$300,000 were undertaken. On arrival, the new head of mission was moved temporarily into the property intended for sale and then refused to move into the leased property. Since August 1996, senior management at headquarters has been negotiating with the mission without resolution. In the meantime, renovations have halted and the leased property has remained vacant.

9.49 The following illustrates why information on spending and revenues needs to be presented using more likely timeframes. The Bureau's latest Plan submitted to the Treasury Board in November 1996 showed projected revenues for 1997-98 of \$84.6 million. These revenues were made up of \$36.2 million from property disposals, \$19.4 million from prior years' disposals, rental revenue of \$3.1 million and parliamentary appropriations of \$25.9 million. Projected expenditures for 1997-98 were \$142 million. However, on the one hand, if disposals were actually to take place as projected in the plan, and expenditures were to remain in the average range of \$30 million to \$40 million (\$36 million projected for 1996-97), the \$25.9 million appropriation would not be needed. On the other hand, if all the projected spending of \$142 million occurred in 1997-98, an additional appropriation of \$57 million would be needed.

9.50 The Long-Term Capital Plan does not serve as an overall financial plan. It is used primarily to match revenues from parliamentary appropriations and disposals with most recent estimates of expenditures in the current year. It has also been used to track regularly the progress of each individual acquisition or disposal project.

9.51 Although the Plan lists projects and their estimated costs, it does not present realistically the fiscal years in which spending on these projects will likely take place. Nor does it present financial strategies for funding projects under different timing assumptions. The Plan shows that most spending will take place in the next fiscal year; however, the Bureau's experience indicates that these expenditures will likely be incurred over several years.

9.52 In addition to the Long-Term Capital Plan, future Business Plans should present likely annual expenditures and revenues. They should also show the financial impact of delaying or accelerating projects or disposals, and the Bureau's strategies for dealing with these possibilities.

Department's response: Agreed.

Maintenance requirements for official residences are not clearly established

9.53 The Bureau inspects properties at every mission at least once every two years. In addition, missions are expected to inspect each of their properties annually. There were no maintenance plans for official residences that had been agreed to by the missions, geographic bureaus, and the Bureau of Physical Resources. In the absence of complete, agreed-upon maintenance plans and detailed maintenance histories, inspection is a key spending control.

9.54 We examined expenditures on official residences for a sample of 5 large and 15 smaller missions where the heads of mission had recently changed. Departmental property managers consider that the most opportune time to do repairs or renovations to a residence is when one head of mission leaves and before another arrives, usually every three years. We found that in the large missions examined, from 1993 to 1996, the cost of work on the official residences ranged from \$79,000 to \$332,000 over an 18- to 24-month period around the time the head of mission changed. In the smaller missions examined, the range was from \$2,000 to \$268,000.

9.55 We compared the work called for in inspection reports prepared by Bureau staff with actual work undertaken. We found that in eight of the 20 cases, in conjunction with the arrival of a new head of mission, missions undertook significant work that was not identified in previous Bureau inspection reports. For example:

- The Department spent \$225,000 at one mission for maintenance, repairs and renovations between September 1995 and the end of September 1996. About one third of this amount involved routine maintenance that normally would not be included in inspection reports. The previous inspection report in February 1994 had identified about \$25,000 for repairs to the roof and electrical system. These repairs were carried out in 1994-95. Staff at the mission identified significant additional work to be done and indicated that they considered the report to be incomplete.

- Another mission undertook \$127,000 of various repairs that had not been foreseen by earlier inspections.

9.56 We could not determine from the documentation whether Bureau staff had participated actively in all major repair and renovation decisions and approved all amounts, as would be normal practice.

9.57 In 12 of the cases, amounts spent were not budgeted fully at the beginning of the fiscal year. Of five large missions, one spent more than double its initial renovation and repair budget for the official residence the year a new head of mission arrived, and three spent about one and a half times their budgets.

9.58 The Department does not keep a centralized record of renovations and major repairs to each property. There was no focal point for analysis of overall spending on a property. The financial system records expenditures, but in most cases we examined, we were not able to tell from those records precisely what work had been done. The Property Manual issued in April 1996 provides guidance to missions on the nature of information related to work undertaken and costs that should be kept in mission property records. At the time of our audit, these guidelines were relatively recent and the information they called for was not always present in property records. In one mission we examined, where large amounts had been spent on the official residence, we were unable to determine from the property file exactly what work was done and to what extent it consisted of repairs, redecoration or renovations to the official residence.

9.59 Our analysis of spending for renovation and repairs to official residences indicates insufficient control by the Department. The Department has spent large amounts on renovating and repairing official residences when

heads of mission changed, without clearly establishing the requirements. Many missions spend large unforeseen amounts of their own operating budgets to improve the official residence when a new head of mission arrives. We could not assess the impact of that spending on other mission priorities.

9.60 The Bureau of Physical Resources should note in its inspection reports whether missions have accurate descriptions of work to be done. Inspections should review work previously carried out and ensure that it has been properly entered into property records. Where missions request significant expenditures for repairs or renovations beyond those in inspection reports, the Bureau or the mission should carry out a new inspection, and the work should be approved by the Bureau.

9.61 Missions and the Bureau of Physical Resources should co-ordinate their efforts in conducting inspections, preparing plans and budgets for renovation and repair, and analyzing significant spending on properties.

Department's response: Agreed. This is predominantly the practice now. A central record will also be kept of significant projects on official residences so that both Mission and Bureau projects are fully documented. The recommended co-ordination process is already being implemented as a result of the 1996 Departmental Review.

It should be noted that it is often economical and efficient to undertake repairs and refurbishments to any housing abroad at the time of the change of occupant. No necessary expenditures have been identified and, in fact, departmental property maintenance and furnishing budgets have been cut.

There are opportunities for savings in representational housing

9.62 In 1995, the Department established representational housing guidelines that resulted in the disqualification of over half the properties used for diplomatic hospitality. As these properties are more spacious than normal staff quarters, the aim was to identify properties for disposal or replace more costly leases with less expensive ones. We were unable to determine if the changes in the representational housing policy are generating the savings expected. The Department had not put in place specific mechanisms to monitor the effectiveness of the guidance provided. During our visits to missions, we noted mixed results from the guidelines. In some cases, former representational houses had become part of the general housing stock. In other cases, large oversized houses were being put up for sale.

9.63 The Department assigns representational housing based on a requirement for substantial in-home official hospitality, for example, monthly sit-down dinners for eight or more guests. To examine the use of these properties, we reviewed the hospitality diaries of 34 program managers at the six missions visited. We found that representational properties were underused for in-home official hospitality. Only in four cases were the program managers meeting departmental guidelines for official hospitality at home.

9.64 In one mission where program managers were given a higher rent allowance of \$8,100 per year to cover the cost of leasing a larger property suitable for representational purposes, none met the minimum level of use expected. In one case, the property was not used at all for official hospitality at home for the full four-year duration of the occupant's posting.

9.65 The Department should re-examine its continuing need for representational housing.

Department's response: Agreed. The fall 1996 Business Plan submitted to the Treasury Board Secretariat made a commitment to develop new housing guidelines to reflect today's cost and space standards, and the fact that in-house representational functions have been significantly reduced because of cuts in hospitality budgets.

Cost-saving initiatives have been undertaken

9.66 In our 1994 Report, we stated that significant cost-saving opportunities existed through reconfiguration of the property portfolio. Departmental information systems did not monitor the reduction in property costs attributable to downsizing at missions separately from those due to cost-saving initiatives.

9.67 Nevertheless, we believe the Department is improving the composition of its portfolio. For example, in London, the Bureau of Physical Resources was able to generate revenues of \$17 million on the disposal of 46 properties. Leases with expiry dates far into the future were retained over leases that were almost expired. In Mexico City, Brasilia and Kingston, Jamaica, we noted that individual managers took initiatives to reduce property costs through renegotiation. In other missions, owned properties were retained over leased properties when missions were downsized.

9.68 The Department has further plans to expend capital funds to achieve savings. For example, it is in the process of disposing of underused and vacant property in Tokyo and replacing it with lower-cost properties for a projected net gain of about \$26 million.

The Department lacks adequate information to manage its property

9.69 Since our last audit, the Bureau of Physical Resources has not yet been successful in developing and implementing an information system that adequately supports its property management function.

9.70 Existing information at headquarters on individual properties was in most cases not timely or accurate and was generally two years old. In the interim, leases have expired, buildings have been sold, occupants have changed and budget data are no longer valid. The Bureau is updating its data from the missions. However, only one third of the missions met the November 1996 milestone for submitting new data, and there are insufficient procedures for ensuring accuracy.

9.71 Inaccurate data on the size of staff quarters is a problem. The Department's Property Manual specifies a method for measuring space, but missions are not fully complying with the methodology. Without accurate data on space, comparative performance measures, such as cost per square metre, cannot be used.

9.72 Mission cost estimates for maintenance in the information system often cannot be traced to projects in the mission property management plans. This lowers confidence in the data system as well as in the plans themselves.

9.73 The Bureau has encountered difficulty in attempting to implement its data systems to support the management of departmental properties. It began work on one new system that it was not able to implement fully. The Bureau has now developed and sent to missions a new system called "PRIME", which it plans to have fully functional by the spring of 1997. We noted that some missions have had difficulty with the new system, both inputting and retrieving data. The system will hold basic data such as property size, location and maintenance budget. However, it will not be able to access the financial system and will not retain information on the maintenance history of a structure. The Department is considering adding a module in 1998 to its proposed new financial system that would hold these data.

9.74 In 1994 we indicated that the development of simple performance measures, such as cost per square metre and cost of accommodation per employee abroad, would improve property management.

9.75 Due to the lack of good information, the Bureau has not been successful in developing reliable performance measures for property at the departmental level. Accuracy of cost data and other basic information, such as property size, remains uncertain.

9.76 The Department should develop a database that includes property maintenance history. Information on property should be linked to the departmental financial information system. The Department should develop performance measures to improve property management.

Department's response: Agreed.

Managing Information Technology

9.77 Over the past five years, the Department has invested approximately \$80 million annually in information technology (IT). In our 1994 Report, we indicated that we would revisit the Department to do more work in the IT area. This report follows up on some themes that we have raised before, and raises new issues.

Global desk-to-desk communications has been achieved

9.78 At the most basic level, SIGNET (Secure Integrated Global Network) represents the Department's capability to send e-mail and share information electronically at over 110 locations around the world. The Department has been successful in achieving unclassified private global desk-to-desk communications with the implementation of SIGNET. However, it has proved to be a greater task than originally envisioned.

9.79 The Department's planned completion date for the roll-out of SIGNET was 31 March 1995. At that time, approximately 96 percent of departmental staff around the world had been connected. Installation at 19 missions out of the 115 missions planned for full SIGNET connectivity remained to be completed. Since then, the Department has connected the 19 missions and has extended the original project to include connecting 41 micro-missions. These 41 missions require a special micro-mission SIGNET solution. The Department's plan was to complete these installations by the end of the 1995-96 fiscal year. As of November 1996, the micro-mission solution was still being finalized. The Department has now begun to roll out fully classified SIGNET at the missions.

Some IT projects were launched without adequate business case analysis

9.80 SIGNET opened up the possibility of a range of information technology services for the Department. Demand for services was not always accompanied by resources allocated to pay for them. At times, departmental processes for approving project funding and tracking costs for IT services were not followed.

9.81 A 1993 departmental policy requires that IT initiatives over \$250,000 be supported by project briefs containing a five-year cost/benefit analysis approved by senior managers. We found examples where this policy was not followed.

- The new Trade Development system, Client Tracking, did not go through this formal approval process, despite a one-year budget of \$280,000 for the ongoing project.
- Implementation of the internal Intranet and employee access to Internet via SIGNET also did not go through the formal approval process; costs of related equipment and software are over the \$250,000 threshold requiring approval.

9.82 The Department has treated separate components of broader IT initiatives, such as Internet access, as separate and incremental. As a result, it did not always do the appropriate cost/benefit business case analysis generally associated with the implementation of IT initiatives. Without this analysis, the Department is not in a position to understand the full implications for its overall budgets and for the organization of providing resources to

its IT activities. The Department has recognized the need for better analysis of proposed IT projects and has initiated a revised project approval process.

9.83 One area where the Department recognizes the need for fully identified costs is the cyclical replacement of SIGNET equipment. The Department is in the process of developing a detailed cyclical replacement plan. This initiative is part of an effort to better manage IT assets by developing and implementing Department-wide IT asset management strategies. A cyclical replacement plan depends on inventory management. Although some missions did not have accurate inventories, the Department is trying to improve its inventory system. Also, we did not find plans for the purchase of IT equipment at the missions, although the missions were spending some of their funds on information technology. We found that some missions show a history of heavy year-end spending with no IT budget planning.

The Department has established a Chief Information Officer (CIO)

9.84 In November 1996, the Department implemented a new governance structure to better manage information technology. Key to the new structure is the Chief Information Officer (CIO). The CIO participates at Executive Committee meetings and is responsible for leadership and vision for the Department's corporate IT strategy as well as the functioning of the committees that will deliver IT governance.

9.85 The Department made the new CIO accountable for consolidating the plans and budgets for all IT expenditures in the Department and recommending priorities. However, we noted that the Department did not explicitly state that the CIO has the authority to track and monitor IT expenditures across the Department. The Department has subsequently reviewed the CIO's mandate and reaffirmed that the CIO does have this authority.

9.86 Departmental staff told us the financial information system was not used in a consistent way for budgeting IT expenditures across the Department. Consequently, the \$10.4 million spent by the Department in 1995-96 on IT equipment was four times the \$2.6 million shown for IT equipment in the departmental financial information system in June 1995, and twice the \$4.5 million shown in March 1996. The CIO recognizes the need to develop a system to identify planned IT expenditures across the Department and monitor actual expenditures against these plans.

9.87 The Chief Information Officer is responsible for promoting Department-wide synchronization of IT projects as well as facilitating their development and implementation in collaboration with staff of the Department and other departments. One of the first major challenges will be the CIO's involvement in the acquisition of the Department's new financial system.

An ambitious timetable set to replace the financial information system

9.88 In 1993, the government decided that its accounting practices should more closely resemble those of the private sector. Introducing this strategy meant that government departments would have to change their computer systems. The government decided that departments must choose from among seven approved financial systems.

9.89 Departments choosing the same system were supposed to agree on what constituted their core accounting activities — those that would form the basis of each department's system. The government believed that by limiting the number of systems, and having departments work in cluster groups and agree on core activities, departments would benefit from shared development costs. The government expected departments to choose their system by 30 December 1996 and anticipated that they would implement their new financial information systems by 1 April 2001.

9.90 The approach of Foreign Affairs and International Trade to choosing its new financial information system was comprehensive and appropriate for the task. The Department consulted broadly and users were involved in

committees developing requirements and reviewing the various systems. Departmental officers commented that this effort was probably their greatest involvement ever in the procurement of a new system.

9.91 In the next phase, the Department intends to contract with a vendor, detail its business processes, and implement its new financial system at headquarters. It has set its delivery date for implementation at headquarters as 1 April 1998, which it recognizes is an ambitious target. Based on discussions with companies involved in implementing systems, departmental officials believe that they can meet the delivery date. The Department had a project under way to confirm the delivery date and to identify costs by the end of March 1997.

9.92 The Department will face several important challenges in the next phase of its project to replace its financial management system:

- The Department has not yet set aside funds internally for the new system, and the preliminary estimate for the cost of implementing the system (\$11 million) may be low. The estimate does not include the costs associated with departmental personnel. Because the Department has some special needs, there will be development work. Programmers are expensive and delays of any kind can affect the cost of delivery. Our experience has been that development work usually takes longer and costs more than anticipated.
- The Department's understanding is that quality assurance for the core activity agreed to by the cluster group will be done in common. However, quality assurance for any add-ons or variations to the core are the responsibility of the department making the changes. This is a crucial area and is sometimes seen as interfering with the speedy delivery of a system.
- The Department has chosen a system that has business processes built into it. These will require the Department to make fundamental changes to many administrative practices.
- Management of change and proper training, needed as a result of changes in business practices, will be critical to the success of the implementation.
- A project of this magnitude requires a project team that will have continuity for the full implementation period. The Department also must have continuous user involvement during and after the implementation phase to ensure a successful outcome. Maintaining a project team and having stable user involvement is a significant challenge for the Department. In the first phase of the project, at least one committee lost members due to postings. As well, the chairpersons of at least two of the committees will not be available for the next phase of the project.
- There are a number of risks associated with the uncertainties inherent in systems under development. One major risk is slippage against project milestones. The Department will need information on a continuing basis on any such slippage to lessen the impact on the system's functional requirements and its planned cost and delivery schedule.

9.93 The Department will have to deal with these and other issues to implement the new financial information system successfully.

Foreign Service Directives (FSDs)

Recent initiatives may lead to simplification

9.94 The Foreign Service Directives have not changed since our 1994 audit. As a result, their size (450 pages) and complexity remain the same as we reported them. In December 1995, a *Report of the Steering Committee for the Fundamental Review of the Foreign Service Directives* was issued. This represented a major comprehensive

effort to re-examine the foreign service allowance structure and the provisions of the FSDs. Although substantive employer/employee discussion concerning these recommendations has not yet taken place, the Report will be a major input to future deliberations on the Foreign Service Directives.

9.95 The Report dealt directly with issues we had raised in 1994 and 1995. It recommended, among other things, that the quasi-legal “underbrush” of the existing directives be cut down and instructions removed entirely, with a view to an 80 percent reduction in overall FSD length and size. It also recommended certain changes to improve the relevance of the directives and to effect potential cost savings. Further, it recommended that the guiding principles of fairness, affordability, flexibility and cost effectiveness be added to the existing comparability, incentive/inducement and program-related FSD principles, with cost effectiveness the overriding principle.

9.96 A 1996 Revenue Canada technical interpretation of the taxable status of several FSDs reversed earlier rulings and required a revision of financially related directives reviewed by Revenue Canada. In response, a working group chaired by the Treasury Board Secretariat prepared some proposed changes to these directives. Foreign Affairs, with advice from Revenue Canada, then rewrote all financially related FSDs so that these employer expenses would qualify as special non-taxable allowances under section 6 of the *Income Tax Act*. An additional working group, using the Steering Committee Report, has examined all FSDs to ensure that they are simpler and more defensible in the present-day context. Results from this work will be presented to the Treasury Board for management approval and then discussed with employee representatives through the National Joint Council.

9.97 The administration of the Foreign Service Directives within the Department appears to have become less time-consuming for employees and administrators in both headquarters and missions abroad. The Department has built upon initiatives noted in 1994, such as developing a Foreign Service Handbook, keeping a record of FSD interpretations and providing automated access to FSD information at the employee workstation. Mission visits have indicated that employees are less preoccupied with FSD issues and interpretation. This broad perception is reinforced by employee use of SIGNET e-mail to access headquarters for FSD advice and specific interpretations. As well, headquarters has been reorganized to provide more timely information and service to staff abroad. This has reduced time spent on FSD-related matters by mission administrative officers and employees at missions abroad.

The capability to analyze costs has been strengthened

9.98 In 1994 we reported that FSD costs were rising without proper review. The Department’s ability to provide and analyze FSD cost information has improved over the past few years. In 1994 the Department did not have an operational cost database to assess FSD expenditure trends effectively or identify specific cost drivers. It has now installed and enhanced an FSD cost database based on a model developed by our Office, with departmental assistance, during the 1994 audit. FSD cost information is also now regularly downloaded from the Department’s financial information system. Cost trends by line object can be calculated and provided to those responsible for FSD decisions.

9.99 Total expenditures under the Foreign Service Directives were \$153 million in 1995-96. We noted that the cost per person posted abroad continued to increase at the same annual rate (nine percent) as reported in 1994. Several factors can contribute to increases or decreases in FSD expenditures, such as the number and profile of Canada-based staff (CBS) posted abroad and the value of the Canadian dollar.

The shared management structure needs to function more effectively

9.100 The Treasury Board Secretariat has stated that responsibility and accountability for the Foreign Service Directives is clear and well established. In its response to the Public Accounts Committee (August 1996), the Secretariat indicated that it ultimately takes responsibility for FSD policy and departments take responsibility for implementation (for example, the use of FSDs, where individuals are posted and at what cost). The Secretariat also

emphasized the importance of the bargaining agents' role in FSD determination (FSDs are negotiated entitlements that supplement the salary of Canada-based staff while abroad).

9.101 The *Report of the Steering Committee for the Fundamental Review of the Foreign Service Directives* indicates that while FSD accountability and responsibility make sense in theory, some question remains as to their effectiveness in practice. The Report recommends, among other things, that macro policy responsibility remain with the Treasury Board Secretariat and day-to-day policy and interpretation be left to departments and, to the extent possible, to managers in posts.

9.102 Two FSD-related issues illustrate that current arrangements for the management of FSDs could be improved. The Department is currently in the process of redesigning the system that determines post differential allowances for staff abroad (FSD 58). However, the Treasury Board is responsible for policy changes of this nature and would normally either lead this activity or delegate this responsibility to others.

9.103 We also noted that the Department has not complied with FSD 70 (Reporting Requirements). It administers the FSDs and, in so doing, collects and retains much of the information on FSD use. Since 1990, FSD 70 has required that the Department provide to the Treasury Board Secretariat annual summary data concerning utilization and costs under various FSDs. To date, the Department has not done so despite requests from the Treasury Board Secretariat.

9.104 **The Department and the Treasury Board Secretariat should integrate their activities more effectively under the current management structure for the Foreign Service Directives.**

Department's response: Agreed.

The management of travel under the FSDs has improved

9.105 In response to the Public Accounts Committee (PAC) in August 1996, the Department stated that internal audit test results indicated that travel irregularities involving "ticket cashing" by departmental employees had stopped.

9.106 Also in response to the PAC, the Treasury Board Secretariat reported that its study of 1993 changes that were made to FSD 45 (Foreign Service Leave) and FSD 50 (Foreign Service Travel and Vacation Assistance) had achieved their purpose, lowered administrative and overall costs, and increased employee satisfaction. The Department, in its response to the Public Accounts Committee, reinforced these observations and provided data that indicate that expenditures under FSDs 45 and 50 have levelled off at a pre-1993 level; however, it did not provide quantitative evidence to support reductions in administrative costs. Our analysis indicates that FSD 45 expenditures have increased slightly and that FSD 50 expenditures have decreased by 14 percent, from \$8.4 million to \$7.2 million over the past two years.

9.107 The Inspector General's Office audited headquarters air travel and hotel costs during the last quarter of 1995-96. Its report concluded that the Department must continue to stress the need to economize on air travel costs; potential exists for cost savings (for example, cheaper fares, use of group travel arrangements); Government Travel Service performance reports on travel for the Department are misleading; and travel management policies across departmental branches range from formal documentation to no consistent practices at all.

9.108 In its 1996 response to the Public Accounts Committee, the Department outlined a series of initiatives that had improved its management of travel. These initiatives include improving account verification, establishing client service standards, implementing statistical sampling of travel claims, establishing an accounts collection committee, modifying departmental financial systems, and providing better information and training to employees. Our review

of these initiatives indicates that the Department has made progress in these areas. As a result, the level of outstanding claims has been reduced from \$3.5 million to \$500,000.

Departmental Reorganization

The Department's management structure is in transition

9.109 In September 1996, the Department began to implement a new organization structure and management process. The number of assistant deputy ministers was reduced from eleven to seven, new roles and responsibilities were assigned to senior managers, and the number of bureaus and divisions was reduced.

9.110 As part of this process, the Department also articulated a series of business lines as the link between the three key objectives of Canada's foreign policy and the process of managing Canada's foreign relations. These business lines are:

- International Business Development
- Trade and Economic Policy
- International Security and Co-operation
- Assistance to Canadians Abroad
- Public Diplomacy
- Corporate Services
- Services to Other Government Departments
- Passport Services.

9.111 The new structure changed existing relationships in the Department. One of the objectives is to increase the extent of collaboration among assistant deputy ministers and introduce a system that will allow for a more effective allocation of resources. Functional assistant deputy ministers develop global policies and initiatives to achieve worldwide the objectives of each business line. The geographic assistant deputy ministers implement each business line within their respective regions. Heads of mission are responsible for program delivery in each country.

9.112 At headquarters, the director-general level — the level immediately below assistant deputy minister — is to be responsible for operational decisions in both the functional and geographic branches. The intent is to have responsibility for financial management reside at this level.

9.113 A common understanding of the nature of the business, and of lines of responsibility and accountability, must be in place for sound financial management practices to spread from the top down throughout the organization. Our discussions with senior officials revealed that there was uncertainty as to how responsibility and accountability would evolve in practice.

9.114 In the area of resource allocation, there was not a common understanding of the roles and responsibilities of the functional assistant deputy ministers relative to those of the geographic assistant deputy ministers.

9.115 At the time of our audit, the Department was going through its first planning cycle under the new structure. In this process, it was working out what these organizational changes mean in operational terms for resource allocation, financial management and control, and accountability for financial performance and results under its lines of business.

9.116 Accountability arrangements for heads of mission also appeared uncertain. Directors–general are to prepare head–of–mission appraisals; yet heads of mission also receive direction from both functional and geographic assistant deputy ministers, and have direct contact with elected officials as well. We were told that annual mission plans were no longer required because they were not considered useful. They were to be replaced by accountability agreements between heads of mission and the geographic assistant deputy ministers. These agreements were to include performance expectations for each of the programs delivered by the missions; however, often they were not prepared. There is no Department–wide requirement that they be prepared, nor is there universal agreement that they should be. Consequently, one of the basic reference points for accountability was absent in many cases.

9.117 Shared responsibility for management and decision making is also present in a number of support areas such as information technology, property management and the Foreign Service Directives. However, this approach makes accountability for decisions and for operating and financial results less clear.

9.118 As part of improving financial management and accountability in its new structure, the Department will need to focus on setting performance targets, measuring results, and linking these back to costs in these support areas as well as for its lines of business.

Conclusion

9.119 In our 1994 audit, we concluded that the Department had improved its financial management practices and controls. We also commented that a few key questions remained to be answered.

- Have these initiatives and changes made a sustainable difference?
- Have the improvements we found been applied consistently across the Department?
- Has the foundation been laid to encourage and assist departmental managers to make responsible and reasonable financial decisions?

9.120 Based on this audit, the answers to these questions are mixed. When the Department has focussed its efforts on improving practices and controls in specific areas, it has been successful. However, the audit also shows that there are other areas where similar efforts are needed.

9.121 Cost awareness and attitudes of stewardship are values that are evident but not yet consistently present across the Department. The new corporate structure, with its reduced number of senior staff, is a visible indicator of the commitment to improve the use of departmental resources. The challenge for senior management is to find a way to reinforce this commitment at all levels and locations throughout the Department.

9.122 The Department is now supported by better financial systems and information. Good planning and project management will be necessary to ensure that the replacement of the financial information system is implemented smoothly and effectively, so that these improvements continue to be sustained.

About the Audit

Background

The issue of financial management and control has been the focus of much of our work over the past 10 years in Foreign Affairs and International Trade. Our 1987 audit of the Department, a follow-up audit in 1989, as well as a 1990 audit observation (concerning the need to improve control of funds advanced to employees) indicated that financial control deficiencies within the Department needed immediate attention and the overall financial function had to be strengthened.

The Public Accounts Committee (PAC), in its Ninth Report to the House of Commons in December 1990, made five recommendations concerning financial management and control in the Department. Accounting for funds advanced to employees was once again the central issue. Our monitoring activities from 1990 to 1993 indicated that departmental progress in responding to these recommendations was slow. With a growing number of reports highlighting incidents of waste and abuse in the Department, we increased our audit effort, culminating in the 1994 Report chapter. The main conclusion was that progress had been achieved in meeting PAC recommendations, but it was not certain that the results of recent departmental efforts for improvement would be sustainable. The latter observation was based on the fact that resolving issues of accountability and system complexity as well as changing employee attitudes take time.

Since 1994, we have maintained a watching brief in these areas. In addition, an audit of travel under Foreign Service Directives (FSD) was reported in May 1995. The results reinforced our 1994 audit findings concerning FSD complexity and cost management.

Scope

This audit was conducted as a follow-up to our 1994 audit of financial management and control in the Department. Accordingly, we examined several areas covered in 1994: financial management practices, property management, internal review, information technology and the Foreign Service Directives. We conducted our audit at departmental headquarters and at six missions.

Objective

The objective of this audit was to examine whether the improvements we noted in our 1994 Report have been sustained since that time.

Audit Team

Robert Anderson
Paul Morse
Marvin Schwartz

Daniel Thompson
Ron Wolchuk

For information, please contact John Hitchinson, the responsible auditor.

Chapter 10

Natural Resources Canada — Energy Efficiency

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Natural Resources Canada — Energy Efficiency

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ellen Shillabeer

Main Points

10.1 Natural Resources Canada (NRCan) has been in the business of promoting energy efficiency for many years. The Department has made a fundamental shift in the way it promotes energy efficiency since the mid-1980s when the emphasis was on grant programs. The Department now sees its role as providing leadership and establishing partnerships with others to reduce energy use and to improve energy efficiency. The current focus is on the environmental impacts of energy use.

10.2 NRCan's current set of 16 non-research and development energy efficiency initiatives is a key element supporting Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000. We found that NRCan's current performance information, on both expectations and achievements, is not sufficient to determine the overall success of its energy efficiency initiatives in terms of the contribution they are making to this stabilization goal.

10.3 Departmental expenditures on these 16 initiatives were about \$16.5 million in fiscal year 1995-96. Of the extensive range of policy instruments available to encourage energy efficiency, the Department uses a limited number of instruments, namely selective regulations, information and voluntary action.

10.4 The objectives established for many of the energy efficiency initiatives do not provide a clear and concrete expectation of achievement against which the Department can assess its progress and report to Parliament. More work must also be done to measure and assess the overall achievements of its initiatives, including the development of appropriate links to the stabilization goal. The Department is taking steps to improve the quality of its performance information, where cost-effective and feasible.

10.5 Opportunities exist to enhance departmental transparency and accountability by better reporting to Parliament on both the performance expectations and performance achievements of the individual initiatives.

10.6 The Department has begun to lay the foundation to improve the energy efficiency of its own facilities and fleet of vehicles, and it expects to achieve its current targets by the end of 1997-98.

Introduction

Background of current Efficiency and Alternative Energy Program

10.7 The Department has a long history of energy efficiency programs. Natural Resources Canada (NRCan), and its predecessor Energy, Mines and Resources, have a long history of programs to promote energy conservation, energy efficiency and alternative sources of energy. Over time, the rationale, focus and approach of such energy efficiency programs have varied greatly.

10.8 The Department initially focussed its efforts on energy conservation, which encouraged behavioural and lifestyle changes to reduce the consumption of energy. For example, people were encouraged to turn down their thermostats and to turn off unnecessary lighting. Today's focus is on improving energy efficiency by promoting a wiser use of energy without sacrificing its benefits or requiring major lifestyle changes. For example, people are encouraged to buy more energy-efficient furnaces and to buy light bulbs that produce about the same light using less energy. Exhibit 10.1 illustrates the changes in the departmental financial commitment to these types of programs over the last 20 years; the following paragraphs describe the changes that have occurred.

Exhibit 10.1

(This exhibit is not available, see the Report)

10.9 During the early 1970s, the Department was mainly involved in the provision of advice to ministers on energy issues, with few programs being delivered. In the mid- to late 1970s, in response to the oil crises of 1973 and 1979, steps were taken to promote energy conservation. These early initiatives were seen as a strategic response to the threat of supply disruptions, which raised concerns about energy security. The concerns were primarily about security of oil supply, in terms of both price and availability.

10.10 Under the National Energy Program of the early 1980s, the departmental expenditures on energy efficiency programs grew significantly, as shown in Exhibit 10.1. Grant programs were used to convince energy users to become more energy-efficient.

10.11 By the mid-1980s, however, energy prices had fallen and energy supplies were increasing. Security of supply was now seen as less urgent by the federal government and the Department. Consequently, the energy policy was changed, departmental financial resources devoted to energy conservation and alternative energy activities began to decline and the Department reduced or eliminated many of its related activities. It redirected its focus toward promoting energy efficiency through research and development, market-based research, demonstration projects and information transfer activities.

10.12 Canada's Green Plan. In the late 1980s, serious concerns began to arise about the impact on the atmosphere of certain human activities. These activities relate primarily to the use of energy that involves the combustion of fossil fuels such as oil, natural gas and coal. In particular, there was a growing worldwide concern about the burning of fossil fuels and the associated greenhouse gas emissions and their implications for global climate change. As a result of this concern and other environmental concerns, the federal government announced, in December 1990, *Canada's Green Plan for a healthy environment*. The Green Plan reported Canada's commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000, commonly referred to as Canada's stabilization goal.

10.13 With respect to limiting greenhouse gas emissions, the Green Plan stated that the immediate emphasis must be on improving energy efficiency across a broad spectrum of uses. The Green Plan committed the federal Minister

of Energy, among other things, to tabling a National Energy Efficiency and Alternative Energy Act and to improving energy efficiency in buildings, equipment, industry and transportation.

10.14 Revised efficiency and alternative energy program. In May 1991, the federal government confirmed that its initial approach to achieving the stabilization goal under the Green Plan was to focus on improving energy efficiency and to promote selected alternative energy sources. In June 1991, the Department received approval from the Treasury Board to implement a revised Efficiency and Alternative Energy (EAE) Program. The objective of the new Program was to support the Green Plan and the National Action Strategy on Global Warming, which was an approach to limiting greenhouse gas emissions.

10.15 This new EAE Program includes a set of energy efficiency initiatives that collectively deal with all end-use sectors (residential, commercial, industrial and transportation) and all major fuel types. The EAE Program was expected to be carried out in co-operation with other departments and agencies of the Government of Canada, and with the provinces, municipalities, energy utilities and the private sector.

10.16 Consistent with a commitment in the Green Plan, the *Energy Efficiency Act* was tabled in Parliament in 1991, received royal assent in June 1992 and came into full force on 1 January 1993. This Act gives the Department the authority to make and enforce regulations concerning the energy efficiency of energy-using products and to promote energy efficiency and alternative energy sources.

10.17 There are 38 initiatives that make up NRCan's current EAE Program, as illustrated in Exhibit 10.2. These include initiatives related to energy efficiency, alternative transportation fuels (such as propane, natural gas, methanol and ethanol) and renewable energy sources (such as hydro, solar and wind). For 1995-96, approximately \$65 million was spent on the EAE Program. The Appendix to this chapter provides additional information on NRCan's energy efficiency initiatives, which were the focus of the audit.

Exhibit 10.2

NRCan’s Current Efficiency and Alternative Energy Program Initiatives

General Programs	Buildings	Equipment	Industry	Transportation	Alternative Energy: Alternative Fuels	Alternative Energy: Renewable Energy Sources
<ul style="list-style-type: none"> • Consumer Information • National Energy Use Database - Advanced Integrated Energy Systems Technologies 	<ul style="list-style-type: none"> • Federal Buildings Initiative • National Energy Codes for Buildings and Houses • Home Program • Home Energy Retrofit • Energy Innovators . Federal Industrial Boiler Program . Buildings Energy Technology Advancement Plan: . Residential Buildings . Large Buildings . Passive Solar Program . Heat Management Research and Development (R&D) 	<ul style="list-style-type: none"> • Equipment Energy Performance Regulations • EnerGuide • Window Labelling • Heating, Ventilating and Air Conditioning Energy Efficiency Rating System 	<ul style="list-style-type: none"> • Industrial Energy Efficiency • Canadian Energy Management and Environmental Training Program . Industry Energy R&D . Industrial Targeted Technologies . Advanced Technologies for Process Optimization and Control . Minerals and Metals Technologies . Gas Technologies R&D Program . Advanced Combustion Technologies Program 	<ul style="list-style-type: none"> • Motor Vehicle Fuel Efficiency Program • AutoSmart • Fleet Energy Program (Fleet Wise, FleetSmart) . Transportation Efficiency R&D 	<ul style="list-style-type: none"> . Propane . Natural Gas . Methanol . Ethanol . Alternative Transportation Fuels R&D 	<ul style="list-style-type: none"> . Renewable Energy Market Assessments . Information and Awareness . Energy from the Forest (ENFOR) . Renewable Energy Technologies Program

Note: Initiatives in bold type are included in the scope of this audit. See paragraph 10.31 for additional information.

10.18 United Nations Framework Convention on Climate Change. In 1992, Canada signed and ratified the United Nations Framework Convention on Climate Change, in which Canada reconfirmed its prior commitment by agreeing to aim to stabilize its greenhouse gas emissions at 1990 levels by the year 2000. In response to this international commitment, federal, provincial and territorial ministers of energy and the environment approved Canada's National Action Program on Climate Change (NAPCC) in February 1995. The NAPCC sets out the strategic directions Canada will follow, a key element of which is promoting greater energy efficiency in all sectors of the economy.

10.19 The Voluntary Challenge and Registry Program. One of the initiatives originally envisaged under the 1991 EAE Program was the Energy Efficiency Challenge initiative. The Climate Change Voluntary Challenge and Registry (VCR) Program, launched in early 1995 by federal, provincial and territorial energy and environment ministers, builds upon this proposed initiative as well as on federal-provincial and multi-stakeholder consultation relating to climate change. The federal government considers the VCR Program to be another key element of Canada's National Action Program on Climate Change, as do the provinces.

10.20 The Minister of Natural Resources, acting as the champion of the VCR Program, has issued a challenge to Canadian companies and organizations, including all levels of government, to develop action plans to voluntarily limit or reduce their greenhouse gas emissions. A registry currently maintained by NRCan records commitments, plans and progress.

10.21 A common goal of NRCan's energy efficiency initiatives and the VCR Program is to limit greenhouse gas emissions. Within the action plans developed for the VCR Program, the participants can use NRCan's energy efficiency initiatives and provincial and company-specific programs to reduce their energy use and their emissions of greenhouse gases. For example, the VCR Program provides opportunities for participants to apply NRCan's Industrial Energy Efficiency Initiative and the Energy Innovators Initiative as part of their involvement in the VCR Program. The federal government's own action plan, submitted to the VCR Program in November 1995 and updated in November 1996, includes the use of two of NRCan's energy efficiency initiatives: the Federal Buildings Initiative and the Fleet Energy Program (FleetWise).

10.22 The federal role and participation in the VCR Program will be examined as part of a future audit of climate change.

Despite improvements in efficiency, energy use continues to grow

10.23 Canada is one of the most energy-intensive countries, in terms of energy use on both a per capita and a gross domestic product basis. Canada's large geographic area, long transportation distances, cold climate and resource-based economy are contributing factors.

10.24 NRCan monitors energy use in Canada, both for the country as a whole and by sector (residential, commercial, industrial, transportation and agricultural), and identifies and analyzes the trends over time. NRCan reports that, in the absence of any improvements in energy efficiency between 1990 and 1994, energy use would have grown by a total of 7.1 percent in all identified sectors. However, largely as a result of improvements in energy efficiency, energy use increased by only about 5.5 percent during that period. Therefore, while actual energy use continues to grow, it is growing at a lower rate.

10.25 NRCan's data show that, over the years, energy efficiency improvements have been realized in the residential, commercial, industrial and transportation sectors. Contributing factors could include the energy efficiency initiatives of the federal and provincial governments, energy utilities and municipalities; improvements in production processes; and global competition. Nevertheless, while improvements in energy efficiency have helped

to offset the increase in energy use, they have not been sufficient to halt its growth overall. Moreover, the Department expects that energy use will continue to respond to the growth in energy-using equipment and in the Canadian population and the economy.

Energy policy framework

10.26 A shared federal–provincial responsibility. Jurisdiction over energy policy is divided between the federal and provincial governments. The provinces own energy resources, and develop energy policies and regulations associated with the management of those resources. Federal powers are primarily associated with interprovincial and international movement of energy and energy-using equipment, and with projects extending beyond a province's boundaries. The federal government also has broad taxation and spending powers. The federal responsibility for energy policy and programs rests mainly with NRCan. Given this jurisdictional division of powers, energy efficiency programs in Canada are a shared responsibility between the federal and provincial levels of government.

10.27 Objectives of federal energy policy. The main objectives of the current federal energy policy are to ensure that:

- Canadians have secure, reliable access to competitively priced energy supplies;
- the development of Canadian energy resources and associated technology offers the maximum economic benefit to Canadians; and
- Canada's energy needs are met and that energy production and consumption are environmentally responsible.

10.28 A comprehensive review of federal government activities in 1994 (Program Review) reconfirmed the importance of NRCan programs that support energy efficiency as well as alternative energy. The 1995 federal Budget and the 1995 Guide to Green Government state that NRCan will reorient energy policy from a focus on increasing traditional sources of supply to an increased emphasis on energy efficiency, alternative and renewable energy sources, the environment and sustainable development.

10.29 Objectives of NRCan's Efficiency and Alternative Energy Program. The main objective of the current EAE Program is to ensure environmental responsibility through limiting greenhouse gas emissions and helping to deal with air pollution issues. Two secondary objectives of the program are related to economic and industrial development and to strengthening Canada's science and technology base.

10.30 NRCan believes that energy efficiency has potential for making a contribution to Canada's short-term stabilization goal. According to the Department, renewable energy sources are not likely to play a significant role in reducing greenhouse gas emissions until after the year 2000. The Department also believes that there is limited short-term prospect for substituting fossil fuels with alternative fuels. Therefore, in the short term, NRCan's primary approach to limiting emissions resulting from the consumption of fossil fuels has been to reduce the use of energy and to improve energy efficiency.

Focus of this audit

10.31 Of the 38 initiatives in NRCan's current EAE Program, we focussed this audit on the overall set of 16 non-research and development energy efficiency initiatives highlighted in Exhibit 10.2, all of which have short-term potential for reducing the use of energy and improving energy efficiency. Two of these 16 initiatives, Consumer Information and National Energy Use Database, distribute and collect information to support the EAE Program as a whole. Only two initiatives, Equipment Energy Performance Regulations and EnerGuide, are regulatory in nature. The remaining 12 energy efficiency initiatives rely on the willingness of others to take voluntary action to reduce

their own use of energy and improve energy efficiency. Total departmental expenditures on the 16 energy efficiency initiatives covered by this audit were about \$16.5 million in fiscal year 1995-96.

10.32 The objectives of our audit were to assess how NRCan determines the continued relevance of its energy efficiency initiatives, to determine whether NRCan is measuring and reporting the performance of these initiatives, and to assess the extent to which NRCan has adopted and implemented energy efficiency measures within its own operations. Further details can be found at the end of the chapter in the section **About the Audit**.

10.33 We expect to audit NRCan's initiatives related to alternative transportation fuels and renewable energy sources at a later date. A future audit of climate change will address other federal efforts directed toward meeting Canada's stabilization goal.

Observations and Recommendations

NRCan Uses a Limited Number of Policy Instruments

10.34 Compared with the 1970s and early 1980s, there has been a fundamental shift in the way the federal government promotes energy efficiency. This shift has been driven by such factors as decreasing federal resources, and reduced concern about oil security. Today, the federal government, and in particular NRCan, addresses energy efficiency by:

- using regulations, very selectively, to eliminate less energy-efficient products from the marketplace;
- educating users and consumers;
- conducting voluntary programs with companies, associations, institutions and other levels of government, including forming partnerships to promote and co-ordinate energy efficiency efforts;
- supporting research and development to develop technologies that increase energy efficiency;
- working with partners to get energy-efficient technologies into the marketplace; and
- refocussing efforts in federal priority areas such as promoting sustainable development, international competitiveness and environmental stewardship.

10.35 The federal government has an extensive range of other policy instruments that it could use to meet its policy objectives, such as taxes, charges and subsidies. However, at this time the government has ruled out certain policy measures, such as a carbon tax on fossil fuels, as a means of causing improvement to Canada's energy efficiency and reducing greenhouse gas emissions. Also, given the federal government's current fiscal restraint, fewer resources are available for major programs such as those similar to the grant and contribution programs of the early 1980s. In addition, there has recently been a general reluctance by the federal government to make extensive use of regulations as a major policy tool.

10.36 In this context, NRCan has used its regulatory powers very selectively, in conjunction with a limited number of policy instruments promoting energy efficiency. The Department views its role as that of serving as a catalyst and providing leadership to others to implement energy efficiency improvements. It attempts to leverage its resources through emphasis on targeted information programs, persuasion and working with others in partnerships

to promote voluntary action. The current energy efficiency initiatives are expected to encourage the identification and adoption of measures that are economical and worthwhile in their own right.

10.37 NRCan has developed partnerships with provincial and territorial governments, municipalities, energy utilities, goods-producing industries, the commercial sector, and non-government organizations. For example, energy efficiency improvements are being encouraged through voluntary industrial programs. The Canadian Industry Program for Energy Conservation (CIPEC), established in 1975, sets voluntary energy efficiency targets in a range of industries. The program includes 33 trade and/or company associations and over 3,000 firms that account for about 90 percent of Canada’s industrial energy use (or about 20 percent of Canada’s consumption of energy).

10.38 Challenges also exist in getting consumers to implement energy efficiency improvements. Factors that impact on the adoption of energy efficiency measures include low consumer energy prices, incomplete data on how energy is used in Canada, lack of consumer knowledge about what can be done to use energy more efficiently, and the low priority that energy users sometimes place on energy efficiency. Although some of these factors can be addressed entirely by the Department or the federal government through the choice of policy instruments, others cannot.

10.39 The Department’s current focus is on encouraging a wiser use of energy, without sacrificing the benefits provided in terms of service or comfort.

Energy Efficiency Initiatives Have Evolved

10.40 We assessed actions taken by the Department over time to ensure that its energy efficiency initiatives continue to be relevant. We found that NRCan has adjusted its energy efficiency initiatives in response to changes in the operating environment. In doing so, it has incorporated and built upon the experience gained in delivering previous initiatives.

10.41 Of the 16 current energy efficiency initiatives, five predate the 1991 revision of the Efficiency and Alternative Energy (EAE) Program. These five initiatives are National Energy Codes for Buildings and Houses, the R-2000 Home Program, EnerGuide, Consumer Information and Motor Vehicle Fuel Efficiency Program. Exhibits 10.3 and 10.4 illustrate the evolution of two of these five initiatives.

Exhibit 10.3

Evolution of the National Energy Codes for Buildings and Houses Initiative

Period	Nature of Departmental Activity
1978	Measures for Energy Conservation in New Buildings were published.
1983	Measures for Energy Conservation in New Buildings were revised. These were promoted as voluntary measures to be used in conjunction with the National Building Code of Canada.
1990-96	The Department co-funded research to develop National Energy Codes for buildings and houses and to develop compliance software and field guides for applying these Codes.
1990	The National Research Council commenced development of new National Energy Codes (buildings and houses), in conjunction with the Department, provincial and territorial governments and utilities. The new Codes were designed to be economically justifiable and sensitive to variations in factors such as regional construction requirements, cost of materials, and energy prices. Another criterion was to provide flexibility in how they are implemented.
1994-95	Drafts of National Energy Codes (buildings and houses) were released for public review.

1995	The Department began supporting the development of implementation tools such as computer programs and training, in conjunction with its partners.
1997	The final version of the National Energy Codes is expected to be published. [Note: The regulation of buildings and houses in Canada is the responsibility of provincial and territorial governments. Neither of these Energy Codes becomes law until adopted by the responsible jurisdictions.]

Exhibit 10.4

Evolution of the R-2000 Home Program

Period	Nature of Departmental Activity
Late 1970s	Work began under the Super Energy Efficient Home Program to carry out research and development (R&D) on more energy-efficient homes.
Early 1980s	The R-2000 Home Program was launched to spur improvement in Canadian residential housing, with the Department demonstrating what could be achieved with the best available technology, building practices and materials. The R-2000 specifications were expected to achieve savings of up to 50 percent of the energy used by conventional homes. The Department continued to fund related R&D and by the end of 1995 more than 7,000 certified R-2000 homes were built in Canada.
1984	The R-2000 Program was formally commercialized when the Department teamed up with the Canadian Home Builders' Association (CHBA) to deliver the Program to its 12,000 member companies across Canada. Although the Department continued to fund related R&D, its focus was on the promotion of the R-2000 standards through development of training programs for builders, and through promotional literature, advertising, exhibits and formal certification of R-2000 homes.
1991	The R-2000 Program was expanded to include new regionally based partnerships to increase market penetration.
1994	The Department produced an upgraded standard for R-2000 construction, in consultation with home builders' associations, provincial governments and utilities. Under new technological requirements, the energy performance of the R-2000 house was to improve by 12 to 15 percent over the existing standards. In response to the demand by partners, the new standards also included environmental and health aspects.
1996-97	The R-2000 Program includes comprehensive training and education for builders, testing and certification of homes, and promotional activities. In co-operation with the CHBA, the Department co-ordinates R&D to improve upon existing R-2000 standards. The Department's new Advanced Houses Program, part of the Buildings Energy Technology Advancement Plan — Residential Buildings initiative, is developing the next generation of improved housing technology.

10.42 Of the 11 remaining energy efficiency initiatives, some are in fact spinoffs of other initiatives. For example, since 1978 NRCan has been involved in administering an EnerGuide labelling program for energy-using equipment as required by the regulatory authority of another federal department. Under the 1992 *Energy Efficiency Act*, the statutory authority for the EnerGuide labelling initiative was transferred to NRCan. The current EnerGuide initiative is a mandatory program that requires manufacturers to affix labels to eight types of major household appliances to provide information to consumers about the products' energy consumption. The 1994 Window Labelling initiative and the 1996 Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System initiative are both voluntary labelling initiatives. They have built upon the concepts of the EnerGuide initiative and expanded them to other products.

10.43 The Home Energy Retrofit initiative, which started in 1993, promotes the use of technologies and building products developed under the R-2000 Home Program. While the R-2000 Program focusses on making energy improvements in the construction of new houses certified to the R-2000 standard, Home Energy Retrofit focusses

on improving the energy efficiency of the more than seven million existing houses and other low-rise residences in Canada. The Department estimates that the owners of many older homes could save up to 25 percent of their heating costs if they made certain affordable upgrades.

10.44 The Fleet Energy Program currently consists of two components: FleetSmart and FleetWise. A previous component, Pro-Trucker, launched in 1985 and phased out in March 1996, promoted energy-efficient driving practices to professional truckers. The two current components build upon the experience gained from Pro-Trucker in developing information products and training modules and in recruiting fleet managers to participate in the program. FleetSmart, to be formally launched in early 1997, is expected to encourage public and private sector vehicle fleet managers to adopt energy-efficient practices and to use alternative fuels. FleetWise, started in 1995, is similar to FleetSmart but directed specifically at federal vehicle fleets.

10.45 As a further example of ongoing adjustments to its energy efficiency initiatives, the Department recently announced improvements to some of its existing initiatives. For example, NRCan plans to make new regulations that will cover electric motors, air conditioners, heat pumps, transformers and other products. It also plans to release a Canadian Home Energy Efficiency Rating System and develop related audit software to help home owners and others identify cost-effective opportunities for energy efficiency retrofits.

Improved Performance Information Needed

10.46 NRCan's energy efficiency initiatives were approved by the federal government to improve energy efficiency in Canada, thereby reducing greenhouse gas emissions. Given NRCan's modest resources and limited policy instruments, most of the initiatives focus on providing encouragement and information to others to reduce energy use and to improve their energy efficiency.

10.47 It is important for the Department, as well as Parliament, to know what these initiatives have achieved over time with the available resources. We therefore expected the Department to have performance information on its Efficiency and Alternative Energy Program and its energy efficiency initiatives to ensure transparency and accountability. We use the term performance information to include both performance expectations and performance achievements. Performance expectations refer to information outlining the performance that is targeted or is expected to occur in the future; performance achievements refer to information on the performance that was actually achieved. These achievements, when compared with stated expectations, allow performance to be assessed. For a given initiative, the performance achievements can be viewed in terms of its outputs and outcomes, as shown in Exhibit 10.5.

Exhibit 10.5

Performance Achievements Continuum

For a given initiative, such as Consumer Information, performance achievements can be viewed along a continuum as follows:						
activity	→	outputs	→	intermediate outcomes	→	long-term outcomes
Example: development of a publication on energy efficiency		publication distributed to consumers		publication used by consumers to make more informed decisions on energy use		actual energy saved as a result of using information contained in the publication

10.48 In the Appendix to this chapter, we have summarized for each of the 16 energy efficiency initiatives the date started, purpose/objective and the departmental expenditures and major achievements over four years. These achievements are expressed primarily in terms of major products and services (outputs) delivered and, where known, outcomes from 1992-93 to 1995-96.

Many energy efficiency initiatives lack clear performance expectations

10.49 We believe that it is important for NRCan to specify, and to make clear to Parliament, what it is trying to accomplish with each of its individual energy efficiency initiatives or sets of initiatives. This information is necessary so that the Department's progress can be assessed.

10.50 As shown in the Appendix, we found that the Department reports an objective for each of its initiatives. These objectives are consistent with the overall objective of the Efficiency and Alternative Energy Program. Each objective is clearly linked to improving energy efficiency by various means in such areas as buildings, homes, equipment and vehicles. However, while each is stated in general terms such as "to encourage" and "to increase", these terms do not provide a clear and concrete expectation of achievement. We found that, for many of the initiatives, there is a lack of reported targets in terms of outcomes against which the Department can assess its progress and report to Parliament.

10.51 As previously noted, the different energy efficiency initiatives use various policy instruments to achieve their objectives. By their nature, some initiatives lend themselves more easily to setting clear and concrete performance expectations or targets in terms of outcomes. For the regulatory initiatives, for instance, the Department does prepare estimates of expected outcomes. For example, NRCan expects the energy efficiency standards for the first 20 products under the *Energy Efficiency Act* to save, by the year 2020, the equivalent of the annual space-heating requirements of 1.5 million houses.

10.52 Only two of the non-regulatory initiatives — the Industrial Energy Efficiency Initiative and the Federal Buildings Initiative — have information on expected outcomes. For example, the Industrial Energy Efficiency Initiative has set a target of an overall average of one percent annual improvement in energy efficiency per unit of output by the year 2000. However, for most non-regulatory initiatives, it is not clear what the Department's expectations are or how it intends to demonstrate the achievement of its objectives.

10.53 **Natural Resources Canada should develop performance expectations in terms of clear and concrete outcomes for all its energy efficiency initiatives.**

Department's response: NRCan has performance expectations for a number of its energy efficiency initiatives. For example, the Industrial Energy Innovators Initiative established and achieved performance targets for: recruiting individual companies and task forces; obtaining Innovator action plans; and meeting carbon dioxide (CO₂) reduction targets for the Canadian Industry Program for Energy Conservation. The Department will continue the further development of performance expectations for its energy efficiency initiatives. Where feasible and cost-effective, these performance expectations will comprise program outcomes and market effects as well as program outputs.

More work needs to be done to measure and assess achievements

10.54 In addition to having clear targets, we would have expected the Department to have information on the achievements of its individual energy efficiency initiatives in terms of their outputs and their outcomes. Both targets and achievements are required to help manage these initiatives and to allow Parliament to judge how well the Department is doing against expectations.

10.55 For performance achievements, we would have expected that, as a minimum, the Department would measure what products or services (outputs) it is producing. We found that, for the most part, it is doing this, as illustrated in the Major Achievements column in the Appendix. For example, under the Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System Initiative, the Department reports that 17 HVAC manufacturers, 90 percent of all such Canadian manufacturers, have joined this voluntary labelling program. This level of representation provides a good example of the extent to which the Department has been successful in building partnerships with industry to promote energy efficiency.

10.56 However, the Department does not have many outcome measurements for its energy efficiency initiatives. For example, it does not always have information on the use made of its approximately 1.5 million copies of publications distributed annually to consumers. Also missing is information on the use made of the advice provided to approximately 40,000 callers to its 1-800 consumer information lines from October 1994 to December 1996. Such information could help the Department assess the value added by its consumer information products, whether they are adequately reaching the targeted audiences and what improvements, if any, could be made to ensure that consumers are properly informed.

10.57 Ideally, the Department would need to know the extent to which its publications or other advice have influenced consumers' decisions affecting energy use, as well as the energy savings that result. We recognize that measuring these intermediate and long-term outcomes is inherently difficult, and can be costly. The outcomes are also difficult to attribute to the Department's initiatives in view of all the other influences that apply. Although the ideal may not be attainable, we believe that the Department needs to continue to explore cost-effective ways of using existing information or developing new sources of information to improve its understanding of the outcomes of its initiatives.

10.58 We found that NRCan is already taking steps to improve the quality of its performance information. To move along the continuum toward improved performance achievements (Exhibit 10.5), the Department recognizes that more work must be done to measure and assess the achievements of its energy efficiency initiatives, including:

- more use of performance measures based on outcomes, where cost-effective and feasible; and
- improved periodic evaluation of the achievements of energy efficiency initiatives.

10.59 In addition, NRCan is focussing on gathering additional data and information to increase its understanding of the outcomes of its energy efficiency initiatives. Much of this work is being carried out through its National Energy Use Database (NEUD) initiative.

10.60 **Natural Resources Canada should continue its efforts to improve its performance information on the achievement of individual energy efficiency initiatives, where cost-effective and feasible.**

Department's response: The Department will continue its efforts to improve the performance information on the achievements of each energy efficiency initiative, where cost-effective and feasible.

NRCan's energy efficiency initiatives are not clearly linked to Canada's stabilization goal

10.61 Two logical and related questions to ask are: What is the Efficiency and Alternative Energy (EAE) Program expected to achieve overall and what contribution is expected from the Department's set of energy efficiency initiatives?

10.62 At the time the EAE Program was established in 1991, the Department estimated that the Program as a whole, including alternative transportation fuels and renewable energy sources, would contribute 30 percent or more to Canada's achieving its stabilization goal by the year 2000. This estimate was based on a number of assumptions

and was dependent, in part, upon the willing and active co-operation of all sectors of the economy and all levels of government. The estimate also served to indicate that the EAE Program alone would not be sufficient to enable Canada to fully meet its stabilization goal, but that it could contribute about 30 percent of the results needed.

10.63 In March 1992, during the House of Commons Legislative Committee hearings on the bill that ultimately resulted in the *Energy Efficiency Act*, the then Minister of Energy, Mines and Resources acknowledged that this estimate was only a “ballpark figure”. The Minister also stated that he did not want to be held to it. The estimate was offered in response to a question on the overall impact of the EAE Program.

10.64 In September 1993, the Department revised its estimate of the outcome of the EAE Program. The revised estimate indicated that, by the year 2000, the Program would contribute only about 20 percent of the stabilization goal, not 30 percent. The Department stated that this reduced expectation for the Program’s outcome was partly a reflection of budget cuts. It also reflected changes in forecast assumptions as well as a clearer understanding of the nature of the EAE initiatives and the likely response from partners and the public. This lower estimate was not disclosed to Parliament by the Department. Moreover, the 20 percent estimate has not been reviewed in light of more recent reductions in energy efficiency programs of provincial governments and energy utilities.

10.65 The Department has not attempted to identify what portion of the projected impact of its EAE Program could be attributed to its set of energy efficiency initiatives, as distinct from its alternative transportation fuels and renewable energy initiatives. However, given the Department’s position that increased energy efficiency has the greatest potential for contributing to the short-term stabilization goal, it would be reasonable to assume that a significant portion of the estimate would have to be achieved through the energy efficiency initiatives.

10.66 We asked the Department if it is able to assess the outcome of its set of energy efficiency initiatives, and thus to make a rational case for the extent of its contribution to improving energy efficiency in Canada and to achieving the overall expectation for the EAE Program. As previously noted, we found that the Department has information on the trends in energy use and on some of the achievements of the individual energy efficiency initiatives, as illustrated in the Appendix. It estimates the impact of all energy efficiency and alternative energy measures in Canada on reducing energy use and limiting greenhouse gas emissions. The Department states that it has avoided preparing estimates of the outcome of its initiatives separately from the initiatives of others because the assumptions would be arbitrary.

10.67 We recognize that it can be difficult for the Department to link the overall outcome of its energy efficiency initiatives to the overall expectations for the EAE Program in quantitative terms. As previously noted, the cost and feasibility of gathering the data must be considered. Quantification of the outcomes of the various initiatives requires additional information on effectiveness, some of which could be obtained from client and data surveys. The Department is working to improve this type of information.

10.68 Nevertheless, we believe that it is important to provide Parliament with qualitative information on the aggregate contribution of its energy efficiency initiatives to the overall expectations of the EAE Program. Such information could address NRCan’s role as a catalyst, the development and maintenance of partnerships, and the maintenance of a presence in all end-use sectors. Additional quantitative information, where cost-effective and feasible to gather, as well as qualitative information would help decision makers in judging whether the energy efficiency initiatives are successful and to what extent these initiatives can be relied upon to contribute to Canada’s stabilization goal.

10.69 **Natural Resources Canada should expand, where cost-effective and feasible, the information it provides on the nature and extent of the contribution being made by its set of energy efficiency initiatives to Canada’s stabilization goal.**

Department’s response: In 1994 and again in 1996, the Department forecast the combined impact of its efficiency and alternative energy measures and those of other jurisdictions on Canadian greenhouse gas emissions. In 1996,

the Department released Energy Efficiency Trends in Canada, which identified and analyzed the factors that caused changes in energy demands and, hence, emissions between 1990 and 1994. The Department will continue to expand its efforts to assess the contribution made by its set of energy efficiency initiatives to Canada's stabilization goal, bearing in mind the difficulties of measuring and attributing the extent of changes in greenhouse gas emissions to individual initiatives.

Improved performance information will improve planning

10.70 Improved performance information on the Department's energy efficiency initiatives can contribute to improved planning by:

- identifying and overcoming factors impacting on adoption of energy efficiency measures;
- determining the optimum level of effort to be applied to each sector and to each initiative;
- identifying opportunities to refocus and consolidate existing initiatives;
- continuing to adapt the current programs to meet changing needs; and
- continuing to explore potential new initiatives by building on prior expertise and knowledge gained.

10.71 The Department's energy efficiency initiatives are delivered by the Energy Efficiency Branch. As part of a government-wide requirement, NRCan developed its first formal business plan for the Branch for the 1996-97 fiscal year. This business plan sets out certain general strategic directions for the Branch. To support this plan, NRCan developed more detailed plans related to each of its energy efficiency initiatives or set of initiatives.

10.72 The Branch has identified a number of opportunities to improve the management of the initiatives and their effectiveness. In addition, it has identified new initiatives that could be implemented as circumstances change. More recently, in June 1996, NRCan entered into a contract with a consultant to provide the Department with advice on delivery of current energy efficiency initiatives. The contractor submitted a report with findings and recommendations in January 1997. Advice was provided to the Department on the strengths, weaknesses and opportunities for significant changes to or extensions of the delivery of these initiatives, within the existing budget and framework.

10.73 We found that NRCan is taking steps in the right direction to improve internal management of its energy efficiency initiatives through enhanced business planning.

Reporting to Parliament needs to be improved

10.74 A number of reports are available to parliamentarians that contain performance information related to NRCan's energy efficiency initiatives or to the Efficiency and Alternative Energy Program as a whole. In 1996, as part of the federal government's Improved Reporting to Parliament Project, the Department tabled a revised Part III of the Estimates early in the year and a new Performance Report in the fall. Also, as required under the 1992 Act, the Department produces an annual Report to Parliament on the Administration and Enforcement of the *Energy Efficiency Act*. In addition, two new reports were prepared and released to the public in 1996: Energy Efficiency Trends in Canada: Energy Efficiency Indicators; and Influencing Energy Use in Canada: Progress Indicators on Initiatives Delivered by Natural Resources Canada.

10.75 These reports generally provide performance information on the achievements of an initiative, such as the number of home builders trained in a given period. However, they typically lack performance expectations in terms

of outcomes, such as how many home builders the Department expected to train or how many builders could have been trained in that same period. This makes it difficult for the reader to judge the success of the initiative.

10.76 Important information is also missing about the environment in which these initiatives are being delivered, the risks and challenges the Department faces, and the underlying assumptions being made. For example, some key assumptions relate to the world oil price, the growth in the Canadian economy, and the level of funding provided to energy efficiency programs by provincial governments and utilities. Such information would help the reader understand the context associated with delivering these initiatives.

10.77 In addition, all of these reports are silent on the original or revised estimate of the contribution these initiatives could make toward Canada's stabilization goal as well as the contribution actually being made. Moreover, the various reports provide different types of performance information. Depending on the date of the report and the nature of the target audience, the information is expressed using different units of measurement, different baselines and different reporting timeframes. In these circumstances, it is difficult for the reader to consolidate the information to determine exactly what the Department has achieved and its contribution to Canada's stabilization goal.

10.78 In its annual Report to Parliament on the Administration and Enforcement of the *Energy Efficiency Act*, NRCan reports the achievements of each of its energy efficiency initiatives on a fiscal year basis and provides summary information on energy use in Canada. However, the report does not make any link between achievements of individual initiatives and improvements to energy efficiency in Canada. Without good performance information, we believe Parliament will find it difficult to judge the success of the energy efficiency initiatives in aggregate terms.

10.79 NRCan's report titled *Influencing Energy Use in Canada* provides more complete information on progress being made by each of the energy efficiency initiatives. In that report, the Department has begun to use a "report card" format that provides a mix of performance information on activities, outputs and, in some cases, outcomes. Exhibit 10.6 provides one example of this type of reporting. In our opinion, this new format represents an improvement over previous reporting formats by showing progress over time and, in some cases, by identifying future expectations. However, where possible, more quantitative information needs to be incorporated in the "report cards".

Exhibit 10.6

(This exhibit is not available, see the Report)

10.80 The Department has recognized the need to assess how best to incorporate this improved information into its annual Report to Parliament on the *Energy Efficiency Act*. NRCan is in transition and is beginning to change to results-based management. It acknowledges that, for the energy efficiency initiatives, it is not in a position to compare planned results or achievements with actual achievements to the extent that it would like to.

10.81 Improvements in reporting performance expectations and performance achievements would improve transparency and enhance the Department's accountability to Parliament for its energy efficiency initiatives.

10.82 **Natural Resources Canada should enhance its reporting to Parliament by consolidating and incorporating improved performance information and by stating any important challenges and underlying assumptions.**

Department's response: Beginning with its 1996-97 Report to Parliament on the Energy Efficiency Act, NRCan will incorporate the type of improved performance information set out in its two new publications (Influencing Energy Use in Canada: Progress Indicators on Initiatives Delivered by Natural Resources Canada; and Energy Efficiency Trends in Canada: Energy Efficiency Indicators). As the Department pursues improvements in measuring

program performance, this additional information also will be incorporated into: the annual Report to Parliament on the Energy Efficiency Act; the Main Estimates; and the Department's Annual Performance Report.

Foundation Laid to Improve Departmental Energy Efficiency

10.83 In November 1994, the Minister of Natural Resources committed NRCan to becoming the most energy-efficient department in the federal government. This commitment was reaffirmed in NRCan's 1996-97 Part III of the Estimates, which states: "NRCan will work to make its facilities the most energy-efficient in the federal government through the Federal Buildings Initiative, and will develop an aggressive Fleet Management Program to reduce costs and showcase alternative transportation fuels." The Department has begun implementing the Federal Buildings Initiative and FleetWise in its own operations.

10.84 One of the targets that the Department established was to reduce its annual energy bill for its facilities by more than 18 percent over 1993-94 levels by the end of the 1997-98 fiscal year. The Department estimates that this will result in energy savings of \$680,000 per year. Under the Federal Buildings Initiative, the Department obtained approval in September 1994 to enter into a contract for the management and implementation of energy efficiency improvements for the Geological Survey of Canada facility located in Calgary. This project, completed in February 1996, is expected to provide average annual energy savings of about \$63,000 per year. In June 1996, the Department signed a contract for its more than 300 other buildings and facilities. The Department stated that at 31 December 1996, approximately 60 percent of the Federal Buildings Initiative energy efficiency improvements had been implemented. The Department expects all improvements to be completed by the end of June 1997 and to meet its energy savings target by 31 March 1998.

10.85 While the Department has set a monetary target to reduce its annual energy bill, this target could be achieved without any energy efficiency improvements if energy prices were to decline by an equivalent amount. Alternatively, if energy prices were to rise, the Department could find it more difficult than expected to achieve its target. However, the Department has expressed this target in units of energy and water consumption and has informed us that these latter targets will be disclosed to Parliament in future Part IIIs of the Estimates and in future departmental Performance Reports. We believe that such disclosure, and reporting achievements against targets expressed in units of energy and water consumption, would enable a better assessment of the success of meeting the target through energy efficiency improvements.

10.86 The new Fleet Management Program covers an initial three-year period from 1 April 1995 to 31 March 1998. It intends to address NRCan's commitments through the following actions:

- reducing the fleet size by 40 percent (from 700 to 420 vehicles) and expanding the use of vehicle pooling;
- improving energy efficiency by increasing driver education, implementing route planning, enhancing vehicle maintenance practices and installing on-board vehicle computer systems to monitor driving practices; and
- advancing the use of alternative fuels through the replacement and conversion of all its vehicles to alternative fuels where cost-effective and operationally feasible.

10.87 At the time of our audit, progress had been made on what NRCan considers to be the most important initiatives within its Fleet Management Program, that is, fleet reduction, vehicle pooling and alternative fuels conversion. The Department has informed us that, as at 31 January 1997, its fleet size had been reduced to 532 vehicles. It expects to reach its interim target of 516 vehicles by 31 March 1997 and its target of 420 vehicles by 31 March 1998.

10.88 In April 1996, the Department began a one-year pilot project at its headquarters complex, which consists of pooling 27 vehicles. The Department plans to evaluate the results of this project in March 1997 to decide whether the project will be extended and expanded.

10.89 The Department informed us that, between 1 April 1995 and 31 January 1997, it converted 35 existing vehicles to alternative fuels and purchased four vehicles that were manufactured with alternative fuel systems. The Department plans to continue converting its existing vehicles and purchasing new vehicles that run on alternative fuel whenever cost-effective and operationally feasible.

10.90 Other actions have begun or are planned on additional energy efficiency aspects of the Fleet Program. A departmental policy on fleet management has been approved and is expected to be distributed in March 1997. A transportation handbook incorporating “green” (energy-efficient and environmentally friendly) driving practices, currently in draft form, is expected to be distributed to all departmental employees by April 1997. To increase driver education, the Department is exploring the possibility of incorporating “green” driving practices as part of an existing departmental course on defensive driving, with a start-up date prior to 31 March 1998. Within the context of its vehicle-pooling project, the Department expects to begin implementing its route-planning software in June 1997, to test on-board vehicle computer systems on three vehicles in the summer of 1997 and to test its enhanced vehicle maintenance practices as opportunities arise.

10.91 Although the Department did not have the necessary information system in place prior to the commencement of the Fleet Management Program, it has developed baseline data for the fuel consumption of its fleet for the first year of the Program. These data could provide a basis for measuring the Department’s future progress on energy efficiency in the transportation area.

10.92 As a result of federal government downsizing measures, NRCan is in the process of reducing its financial, physical and human resources. For the Federal Buildings Initiative, the Department has included clauses in its contracts to adjust the baseline data to take into account external influences, including reductions due to departmental downsizing. This could assist the Department in considering these reductions when reporting on the achievements of its own energy efficiency efforts for its buildings and facilities. To ensure fair and proper reporting of the achievements of its energy efficiency efforts in the transportation area, as distinct from reductions in energy consumption brought about by downsizing, the Department needs to examine ways to separate the impacts of downsizing from other measures it is taking to reduce energy use.

10.93 In our opinion, NRCan has begun to lay the foundation to improve its own energy efficiency. While additional achievements are required in certain areas, the Department expects to meet its commitments or targets by 1997-98.

Conclusion

10.94 NRCan has been in the business of promoting energy efficiency for many years. However, the policy drivers, delivery mechanisms and resources have changed significantly over time. The focus has moved from an initial concern about security of supply to a concern about the environmental impacts of energy use.

10.95 The Department has made a fundamental shift in the way it promotes energy efficiency. Today it places heavy reliance on voluntary measures, with only selective use of regulations. It acts as a catalyst, and attempts to leverage its limited resources by using partnerships to encourage others to use energy more efficiently. For the most part, the departmental role is to provide federal leadership to others to implement energy efficiency improvements in Canada.

10.96 Improving energy efficiency is a key element in enabling the federal government to achieve its commitment to stabilize greenhouse gas emissions at 1990 levels by the year 2000. This is a major commitment to which NRCan is expected to make a significant contribution.

10.97 Information is not available on the contribution that is being made, or that could be made, to Canada's stabilization goal by the set of energy efficiency initiatives. We found that the current performance information is not sufficient to determine the overall success of the initiatives in contributing to this goal. The Department needs to develop appropriate links between the outcome of its energy efficiency initiatives and the stabilization goal.

10.98 Our audit also identified the need for improved performance information pertaining to the individual energy efficiency initiatives, where cost-effective and feasible. In addition, there are opportunities to enhance the transparency of the energy efficiency initiatives and departmental accountability, by better reporting to Parliament on expectations and achievements.

10.99 In November 1994, the Department committed itself to becoming the most energy-efficient department in the federal government. The Department has made progress over the last two years toward improving its energy efficiency and expects to meet its targets by 1997-98.

About the Audit

Objectives

Our audit objectives were:

- to assess whether the purposes of NRCan's energy efficiency initiatives are in line with current government policy and departmental objectives, and how NRCan determines their continued relevance;
- to determine whether NRCan is measuring and reporting the performance of the energy efficiency initiatives; and
- to assess the extent to which NRCan has adopted and implemented energy efficiency measures within its own operations.

Scope

Our audit focussed on the set of 16 energy efficiency initiatives of NRCan's Efficiency and Alternative Energy (EAE) Program that are not related to research and development.

The quantitative information in this chapter has been drawn from the various government sources indicated in the text. Although this quantitative information has been checked for reasonableness, it has not been audited unless otherwise indicated.

The other initiatives of NRCan's EAE Program related to alternative transportation fuels and renewable energy sources are expected to be covered in separate audits at a later date.

Audit Team

Ian Campbell
Robert Pelland
Jerry Rosinski
Mary Louise Sutherland

For information, please contact Ellen Shillabeer, the responsible auditor.

Appendix

Energy Efficiency Initiatives — Purpose/Objective, Departmental Expenditures and Major Achievements (1992-93 to 1995-96)

General Programs

The general programs provide support to all the other initiatives by collecting and analyzing data and distributing information.

Initiative	Purpose/Objective	Departmental Expenditures 1992-93 to 1995-96 (Note 1)	Major Achievements 1992-93 to 1995-96
Consumer Information (started 1970s)	To increase Canadians' awareness of the environmental effect of energy use and to encourage energy-efficient practices and the use of alternative energy sources	\$5.1 million	<ul style="list-style-type: none"> • distributed each year approximately 1.5 million copies of over 300 Efficiency and Alternative Energy publications • provided a broad range of marketing activities including publications, exhibits, magazine articles, animated public service announcements and calendars • provided newspaper supplements on energy efficiency to 3.8 million households
National Energy Use Database (NEUD) (started 1991)	To give decision makers the information on secondary energy consumption in Canada that they need to assess progress in improving energy efficiency and to analyze opportunities for further improvement	\$6.8 million	<ul style="list-style-type: none"> • funded several surveys, such as: <ul style="list-style-type: none"> - Survey of Household Energy Use, 1993 - Survey of Canadian New Household Equipment Purchases, 1994 and 1995 - Survey of Houses Built in Canada, 1994 - Home Energy Retrofit Survey, 1994 and 1995 - National Private Vehicle Use Survey, 1994, 1995 and 1996 - Industrial Consumption of Energy Survey, 1994 and 1995 • established five data and analysis centres in universities across Canada, with each centre focussing on a different sector of the Canadian economy (i.e. residential, industrial, commercial, agricultural and road transportation for private vehicles)

Energy Efficiency - Buildings

These initiatives focus on improving energy efficiency in existing and new homes and buildings.

Initiative	Purpose/Objective	Departmental Expenditures 1992-93 to 1995-96 (Note 1)	Major Achievements 1992-93 to 1995-96
Federal Buildings Initiative (FBI) (started 1991)	To encourage comprehensive energy efficiency upgrades and retrofits in federal government facilities	\$2.8 million	<ul style="list-style-type: none"> • provided a full package of products and services to federal departments and agencies including financing arrangements and a list of qualified contractors • assisted all federal custodial departments (11) in setting up 35 energy efficiency contracts, which are at the preliminary engineering, tendering or implementation phases • established strategic alliances with energy utilities and industry associations to promote the Federal Buildings Initiative (FBI) with their members • obtained private sector commitment as of March 1996 to invest \$120 million in federal facilities that are expected to yield an estimated \$17 million in annual energy savings • assisted five provincial governments, several municipalities and two Crown corporations and agencies to adopt the FBI model
National Energy Codes for Buildings and Houses (started 1990)	To increase the energy efficiency of new Canadian buildings by specifying minimum thermal performance levels and supporting the incorporation of these energy codes into provincial and municipal building regulations	\$3.1 million	<ul style="list-style-type: none"> • collaborated with the National Research Council (NRC), utilities and other levels of government to develop National Energy Codes (these are expected to be published by NRC in 1997) • raised awareness of the Codes through exhibitions, presentations and conferences
R-2000 Home Program (started late 1970s)	To increase the energy efficiency in new houses	\$7.6 million	<ul style="list-style-type: none"> • certified over 4,000 R-2000 houses, representing .68 percent of national housing starts; and over 10 percent of the starts in New Brunswick and over 4 percent in Nova Scotia for 1995-96 • trained about 3,500 builders in R-2000 standard • promoted the building of R-2000 houses through national and regional building associations, product manufacturers and equipment suppliers
Home Energy Retrofit (started 1993)	To encourage Canadians to make their homes more energy-efficient, especially when undertaking home renovation and maintenance projects	\$2.4 million	<ul style="list-style-type: none"> • encouraged the consideration of energy efficiency in renovations by providing information through newsletters (Retro-Vision), consumer campaigns, national marketing initiatives (RenoSense) and through six demonstration projects • developed draft guidelines for home energy rating system
Energy Innovators Initiative	To encourage corporations, institutions and municipalities to increase the energy efficiency of their facilities	\$3.3 million	<ul style="list-style-type: none"> • enrolled more than 300 organizations controlling about 17 percent of Canada's total commercial floor space, to reduce their energy consumption and to increase the energy efficiency of their facilities

(started 1991)			<ul style="list-style-type: none">• provided information, models, training, guidebooks, project financing options, list of qualified energy service companies, workshops and databases
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Energy Efficiency - Equipment

These regulatory and voluntary initiatives focus on improving the energy efficiency of residential and industrial products.

Initiative	Purpose/Objective	Departmental Expenditures 1992-93 to 1995-96 (Note 1)	Major Achievements 1992-93 to 1995-96
<p>Equipment Energy Performance Regulations</p> <p>(first regulations came into effect in 1995)</p>	<p>To eliminate less efficient energy-using equipment from the Canadian market by establishing minimum energy-efficiency performance levels for equipment</p>	<p>\$4.3 million</p>	<ul style="list-style-type: none"> • drafted <i>Energy Efficiency Act</i> in 1991 (came into full force in January 1993) • originally regulated 20 residential products, accounting for 60 percent of residential energy demand • subsequently regulated two additional products that pertain to certain types of lamps • produced and distributed Guide to the Energy Efficiency Regulations, Lamp Replacement Guide and fact sheets on electric motors and lighting products • implemented a compliance regime for regulated products
<p>EnerGuide</p> <p>(started 1975 under Consumer and Corporate Affairs legislation; moved to NRCan legislation in 1992)</p>	<p>To encourage consumers to purchase energy-efficient equipment by disseminating information on the energy performance of a range of competing products</p>	<p>\$5.2 million</p>	<ul style="list-style-type: none"> • introduced new EnerGuide label for eight types of regulated household products to indicate each product's energy consumption and relative energy efficiency • published EnerGuide directory for consumers, as part of the Equipment Energy Performance Regulations • issued guides to appliance industry to improve labelling practices • developed training program for retail industry
<p>Window Labelling</p> <p>(started 1994)</p>	<p>To encourage consumers to buy energy-efficient windows by informing them about the product's energy performance</p>	<p>(Resources included under National Energy Codes for Buildings and Houses)</p>	<ul style="list-style-type: none"> • eight window manufacturers (representing 10 percent of the market) joined the voluntary labelling program consistent with EnerGuide • about 65,000 certified windows and patio doors available on the market
<p>Heating, Ventilating and Air Conditioning (HVAC) Energy Efficiency Rating System</p> <p>(started 1996)</p>	<p>To encourage consumers to buy energy-efficient furnaces and central air conditioners by informing them about the energy performance of these products</p>	<p>(Resources included under EnerGuide)</p>	<ul style="list-style-type: none"> • HVAC manufacturers (representing 90 percent of all such Canadian manufacturers) joined the voluntary labelling program consistent with EnerGuide • provided training materials and other products and services for dealer education programs

Energy Efficiency - Industry

These initiatives focus on assisting industry in improving energy efficiency.

Initiative	Purpose/Objective	Departmental Expenditures 1992-93 to 1995-96 (Note 1)	Major Achievements 1992-93 to 1995-96
<p>Industrial Energy Efficiency</p> <p>(started 1992)</p>	<p>To increase energy efficiency in the manufacturing and mining sectors</p>	<p>\$4.7 million</p>	<ul style="list-style-type: none"> • established a framework consisting of an advisory council of senior industry executives, the Canadian Industry Program for Energy Conservation (CIPEC) and the Industrial Energy Innovators Initiative • under this framework the following was accomplished: <ul style="list-style-type: none"> - recruited and encouraged 255 industrial energy users to develop long-term energy management planning - developed a 1990 baseline for energy use in each of the manufacturing, mining and forest products sectors - established 14 industrial sector task forces (committed to an overall average of one percent annual energy efficiency improvement per unit of output by the year 2000; 11 of the task forces have finalized their action plans) - completed six studies on sector energy efficiency potential and end use - developed a system to monitor and report on industry's progress toward its targets - recruited/encouraged 33 trade and/or company associations to become involved in the Program
<p>Canadian Energy Management and Environmental Training (CEMET) Program</p> <p>(started 1992)</p>	<p>To provide energy users with opportunities for skills development in energy management</p>	<p>\$2.0 million</p>	<ul style="list-style-type: none"> • operated through affiliated community colleges and other delivery agents where approximately 30 courses per year are delivered • trained almost 1,000 students in a variety of energy management courses and workshops • developed training courses, strategies and educational material

Energy Efficiency - Transportation

These initiatives focus on promoting the manufacture of fuel-efficient vehicles and energy-efficient practices in the purchase, operation and maintenance of vehicles.

Initiative	Purpose/Objective	Departmental Expenditures 1992-93 to 1995-96 (Note 1)	Major Achievements 1992-93 to 1995-96
<p>Motor Vehicle Fuel Efficiency Program</p> <p>(formerly known as Motor Vehicle Fuel Consumption, which started in 1978, and was expanded and renamed in 1995)</p>	<p>To inform purchasers of new cars, light trucks and vans about the fuel efficiency of these vehicles and to encourage motor vehicle manufacturers to undertake further improvements in vehicle fuel efficiency</p>	<p>\$.5 million</p>	<ul style="list-style-type: none"> produced and distributed the Fuel Consumption Guide (approximately 300,000 per year) and promoted public education projects in co-operation with Transport Canada assisted manufacturers to provide fuel consumption labels for new vehicles for fuel consumption comparisons signed three Memoranda of Understanding (MOUs): one with the Motor Vehicle Manufacturers' Association in November 1995, another with the Association of International Automobile Manufacturers of Canada in February 1996, and a third with the U.S. Department of Energy on Road Transportation Energy Efficiency and Alternative Fuels in March 1996 (the MOUs with the manufacturers are expected to provide an opportunity to obtain further voluntary commitments on fuel efficiency)
<p>Auto\$mart</p> <p>(started 1994)</p>	<p>To encourage motorists to make fuel-efficient decisions in the purchase, operation and maintenance of their vehicles</p>	<p>\$2.5 million</p>	<ul style="list-style-type: none"> increased awareness of transportation energy efficiency through consumer publications, advertising, driver training and joint initiatives with public and private partners distributed more than 150,000 Auto\$mart publications in 1995-96 received a total of 4,000 calls to the 1-800 information line on Auto\$mart since it was launched
<p>Fleet Energy Program</p> <p>(started 1995)</p>	<p>To help public sector and commercial fleets reduce fuel costs and vehicle emissions through energy-efficient decisions in their fleet operations</p>	<p>Pro-Trucker - (started 1985) \$1.0 million</p> <p>FleetWise - (started in 1995) \$.2 million</p> <p>FleetSmart - (to be formally launched in early 1997) \$1.5 million</p>	<ul style="list-style-type: none"> provided information materials, workshops, technical demonstrations and training programs trained about 22,500 professional truckers in energy-efficient driving practices in the Pro-Trucker program signed on about 270 federal fleet managers to FleetWise (these managers are expected to cut costs, improve energy efficiency, minimize environmental effects of the more than 25,000 federal vehicles and encourage use of alternative fuels in the federal fleet) contacted about 200 private fleet managers to encourage their participation in FleetSmart when launched - to save fuel and reduce operating costs through energy efficient practices

Sources: Annual Reports to Parliament on the Administration and Enforcement of the *Energy Efficiency Act* and other departmental information.

Note 1: NRCan's partners also contribute funds to the delivery of some of the energy efficiency initiatives.

Note 2: The quantitative information in this Appendix has been checked for reasonableness.

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To The Honourable the Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 1997 to the House of Commons, to be laid before the House in accordance with the provisions of section 7(5) of the *Auditor General Act*.

L. Denis Desautels, FCA
Auditor General of Canada

OTTAWA, 7 October 1997

April and October 1997

Foreword and Main Points

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Report of the Auditor General to the House of Commons for April and October 1997

Foreword

I am pleased to present the April and October volume of my 1997 Report. Bound with this Foreword are the Main Points of 21 chapters, which are issued separately. The tabling of chapters 1 through 10 had been planned for April, but was deferred when the 35th Parliament ended with the call for the federal election of last June. This Report volume contains the following chapters:

1. Maintaining a Competent and Efficient Public Service
2. Financial Management: Developing a Capability Model
3. Management of the Government's Accounting Function: A Central Agency Perspective
4. Control of the Transboundary Movement of Hazardous Waste
5. Reporting Performance in the Expenditure Management System
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Ongoing change has become a permanent feature of the federal government as it continues to seek more efficient, economical and effective ways of delivering programs and services to Canadians. The effects of recent downsizing and budget cuts are still being felt, even as public servants engage in re-engineering and redesigning the way they must work in the future to be able to adjust to new realities.

Part of this redesign involves changes to the basic infrastructure for accountability in the federal government. Several chapters in this Report reflect ongoing work by this Office to help ensure that in its changes the government “gets the fundamentals right.” Studies reported here will serve as a foundation for much of the audit work we plan to carry out in the months ahead.

The government’s use of alternative, market-like mechanisms to deliver services is increasing at the same time as many of the rigid rules and procedures of the past are being challenged. This makes it more critical than ever that decision makers have the right information at the right time. The Report highlights the need to improve the quality of information for financial management and to modernize the systems that produce it. Cost awareness and an attitude of stewardship for resources need to be encouraged at all levels.

In particular, the Report discusses recent initiatives by the government to transfer to the private sector the delivery of some services. It highlights lessons learned to date that, if heeded, should result in greater protection of the taxpayers’ interests in any future such transfers.

The Report also stresses the need for senior managers to know and state more clearly what they expect their programs and activities to achieve, and to measure and report in more concrete terms the results they attribute to those efforts. Knowing where resources have had the desired effect -- and where they have not -- will enable decision makers to continue successful activities or make the necessary adjustments to provide Canadian taxpayers with the best value for their money.

Moving toward Managing for Results

Assistant Auditor General: Maria Barrados

Responsible Auditor: John Mayne

Chapter 11 - Main Points

11.1 Meeting Canadians' expectations for cost-effective programs requires that government managers focus on achieving results, especially benefits for Canadians. Basing decisions on results is vital as government reviews its involvement in program delivery and relies more on delivery by third parties. However, we found that managing for results is not widespread in government. In the past, managers have tended to focus on the resources they used, the activities they carried out and the procedures they followed.

11.2 A number of recent government initiatives support a focus on results, but concerted effort is required to bring about change. This study sought to support this change by drawing together experience from Canadian government programs and some other jurisdictions that have made significant progress. We selected examples for the study that illustrate different contexts and approaches.

11.3 We found cases where managers were measuring performance, communicating results information internally and externally and using the information to improve results. Managers of these programs were able to point to improvements in the key outcomes that they and their ministers were trying to achieve for Canadians. They also found that managing for results improved their management practices, program activities and programs' credibility.

11.4 The way managing for results is implemented will vary depending upon the situation of a particular program, but we found a number of consistent themes. Senior management leadership and commitment at all levels of government are particularly important. Effective managers create an organizational climate that encourages managing for results. Also important is agreement on the results to be expected and how to measure them. Although difficult to achieve, such agreement is necessary in order to focus activities and permit an assessment of progress.

11.5 Continued progress in managing for results will require ongoing leadership and attention across government. In particular, decision makers need to show that results count, by asking about results and visibly using them to make decisions.

Information Technology: Preparedness for Year 2000

Assistant Auditor General: Doug Timmins

Responsible Auditor: Nancy Cheng

Chapter 12 - Main Points

12.1 The “Year 2000” crisis is a global phenomenon. It refers to the potential for systems errors, malfunction and failure as a result of the past practice by computer professionals and the information technology community of representing the year as a two-digit code. Year 2000 can threaten the functioning of government systems that support the delivery of programs and services to the public, as well as internal operations. The costs of dealing with Year 2000 issues have been estimated at as high as US \$600 billion globally. In Canada, total costs are estimated to range from \$30 billion to \$50 billion. The Treasury Board Secretariat has estimated the costs for the Canadian government at \$1 billion.

12.2 Year 2000 has been widely recognized as one of the largest information technology projects. The deadline is immovable and the next millennium is less than three years away. We concluded, as of the end of April 1997, that the rate of progress in mitigating the risks of systems errors and failure has generally been slow, and the residual risks are high. In addition, significant exposures such as competing priorities for systems development and insufficient technical resources could, if they materialize, jeopardize Year 2000 efforts.

12.3 The Treasury Board Secretariat has helped to raise awareness across government and facilitated the exchange of views and experiences on Year 2000 efforts. Its Year 2000 project office has been working with departments and agencies to identify and find solutions to common problems. The Secretariat advised us that its submission for funding government-wide initiatives was approved in late June for presentation to the Treasury Board during the summer of 1997.

12.4 However, if progress were to continue at the rate we observed at the time of the audit, it would likely be too slow to ensure that the government systems, including those that are critical to supporting major programs and essential services, will be ready in time. We are concerned that systems supporting government programs and services remain at risk. Failure of critical systems could affect public health and safety and essential services to the public. In our view, Year 2000 is a serious threat that requires urgent and aggressive action.

12.5 We have recommended that Year 2000 projects, including the development of contingency plans, be ranked among top priorities of departments and agencies. In addition, we have recommended that the Secretariat give high priority to its initiative on overseeing the successful implementation of the most critical systems for the government as a whole. We have also emphasized the need for sustained commitment and support from senior management and for continued engagement of ministers, as appropriate, to address exposures and roadblocks that can derail Year 2000 projects.

Health Canada - First Nations Health

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ronnie Campbell

Chapter 13 - Main Points

13.1 First Nations health is significantly worse than that of the general Canadian population. The health status of the First Nations population is affected by poor socio-economic conditions, which present considerable challenges to Health Canada and others who deliver health services to First Nations.

13.2 The management of community health programs through separate contribution agreements needs improvement. Health Canada does not monitor contribution agreements effectively. Clear and detailed descriptions of the programs to be undertaken in specific communities were often not available. In about two thirds of the agreements we examined, the Department did not have the required information on the activities carried out in the communities.

13.3 A sound framework for the transfer of health programs to community control has been developed and has allowed First Nations to start managing their own health programs. However, this framework has not yet been fully implemented. Required reports seldom provide performance information related to health, and requirements for program audits were not adequately met. In addition, the evaluation of the transfer initiative did not include any measures of changes to health.

13.4 Significant weaknesses exist in the management of pharmacy benefits under the Non-Insured Health Benefits program, allowing clients to access extremely high levels of prescription drugs. Although the Department has been aware of the problem of prescription drug misuse for almost 10 years, we found no evidence that the ease of access to prescription drugs has changed in any significant way. Despite the seriousness of the problem and numerous reports of prescription drug addiction and prescription-drug-related deaths in First Nations communities, action to intervene has been slow.

13.5 In an attempt to address program weaknesses, Health Canada is currently testing a point-of-service system that is to be fully implemented in the fall of 1997. Such a system has the potential to be a key mechanism in the control of drug use and the administration of pharmacy benefits. However, the Department needs to provide a clear protocol to guide intervention and will need to closely monitor pharmacists' overrides of warning messages.

13.6 Dental care providers tend to provide services up to the established frequencies and limits rather than based on needs, resulting in overservicing of some First Nations clients. The Department has piloted a predetermination process and plans to implement this needs-based model for the dental benefit nationally.

13.7 The Department has successfully implemented some cost management initiatives, resulting in a reduction in the rate of increase in direct program costs for non-insured health benefits from 22.9 percent in 1990-91 to 5.6 percent in 1995-96. However, further savings can be achieved in other areas, including dispensing fees and medical transportation. In addition, management needs to strengthen verification of claims and audits of providers.

Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish

Assistant Auditor General: Don Young

Responsible Auditor: Doug Timmins

Chapter 14 - Main Points

14.1 Although many Atlantic fisheries continue to thrive, the 1990s saw the collapse of most of Atlantic Canada's commercial groundfish fishery. As Atlantic groundfish stocks headed toward their lowest levels in recorded history, Fisheries and Oceans Canada and the Northwest Atlantic Fisheries Organization progressively closed most of the commercial Atlantic groundfish fisheries and significantly reduced the total allowable catch for others.

14.2 To address this situation, the federal government implemented income support and adjustment programs to help those dependent on the fishery and also undertook specific initiatives designed to improve fisheries resource management and bring industry capacity into line with the size of the groundfish resource. The government will have spent over \$3 billion of new and reallocated program funds this decade. While some progress has been made, many of the critical problems related to the fishery remain, particularly the excess capacity to catch fish, and the number of people relying on the fishery and associated income support programs remains high.

14.3 Managing the seasonal and labour-intensive Atlantic groundfish fishery on a sustainable basis is extremely challenging. Decision makers face the imprecision inherent in determining the status of fish stocks as well as pressure from fishers, plant workers and industry to maintain access to and income from the fishery, access to employment insurance during the off-season, and access to alternative forms of government support in times of crises.

14.4 Although Fisheries and Oceans Canada has stated principles for a fishery of the future, measurable indicators to assess progress are required. While progress has been made in reducing the number of groundfish licences, excess harvesting capacity in terms of an ability to kill fish remains. The Department needs to further its efforts to identify the extent of the contribution of environmental and other factors to the decline of the groundfish. In addition, fisheries management practices need to be further improved to better manage the risks and uncertainty inherent in managing the fishery as a sustainable resource. A precautionary approach to conservation must be the priority and unsustainable fishing practices need to be addressed.

14.5 The Department has stated that its mandate is conservation of the fishery resource base and that this is implied in current legislation. Nevertheless, we found no clearly stated national policy for sustainable fisheries. In addition, performance indicators need to be further developed and planning and performance reporting processes need to be better integrated.

14.6 The deep cultural attachment to the groundfish fishery has been reinforced by several decades of government subsidies. This has resulted in substantial pressure on government to maintain the status quo; that is, to use the fish as a basis for providing income support. Successive governments have provided increasing income support for the people living in the remote coastal communities in Atlantic Canada. This reaction to social pressures has not resulted in an economically viable fishery. In fact, the absence of the fishery has revealed, more clearly than ever before, the substantial reliance on income support by a significant portion of the Atlantic fishing industry. This reliance makes dealing with already complex problems of overcapacity and fisheries management more difficult.

14.7 With the future of groundfish uncertain, the problems remain critical. In our view, the Department, in conjunction with the government, needs to take further steps to implement the principle that “conservation is the paramount priority”, as well as to continue to pursue efforts to ensure that resource management decisions reflect the principle that “harvesting capacity must match the available resource base.” At the same time, the government must deal with difficult socio-economic decisions about the future of those whom the fishery cannot support, if fisheries management is to ensure an ecologically and economically sustainable fishery.

Fisheries and Oceans Canada — Rationalization and Renewal : Atlantic Groundfish

Assistant Auditor General: Don Young
Responsible Auditor: Doug Timmins

Chapter 15 - Main Points

15.1 The Department has identified the need for fundamental changes in the fishery, in its relationship with the industry and in its management practices, in order to achieve a sustainable fishery. Since 1992, the Department has moved to reduce the number of groundfish licences, made changes in the management of the fishery and is developing new arrangements for the sharing of responsibility for managing the fishery in the future.

15.2 A key objective of The Atlantic Groundfish Strategy (TAGS) and other initiatives is to reduce existing harvesting capacity by at least 50 percent over the long term. The allocation of funds to reduce harvesting capacity under TAGS, originally \$300 million, was subsequently reduced to \$97 million. The Department focussed its capacity reduction efforts on the removal of licences and is paying about \$88 million of this amount to fishers to retire 545 groundfish licences and 266 fishers without licences. The Department would have been able to reduce more licences had the funds allocated to licence buyback and retirement not been reduced by almost \$200 million. A further 2,626 licences have been identified for eventual removal from the fishery once the current licence holders exit the fishery. Assuming that the Department is able to effect the removal of these licences, it will have removed approximately 23 percent of the groundfish licences in place at the time TAGS was introduced. However, this will still leave about 10,000 groundfish licences, a portion of which represents the groundfish harvesters who historically caught most of the fish. Thus, significant overcapacity, in terms of the ability to catch fish, will remain.

15.3 The Department has made many changes to its groundfish management activities since 1992, which it believes represent improvements over practices that were previously in place. These changes include the introduction of conservation measures in conservation harvesting plans and the integration of fisher knowledge in groundfish management. Nonetheless, fisheries management practices need to be further improved to ensure the sustainability of the resource base.

15.4 Past management practices were introduced with the intention of ensuring conservation. For a variety of reasons, these practices were not successful when implemented. To deal with the inherent uncertainty of the resource base, a precautionary approach is required as a basis for decisions. In addition, further improvements are necessary in catch monitoring, and enforcement must become a more important and active component of groundfish management.

15.5 While implementing Program Review cutbacks, the Department is also reorganizing. Its long-term strategy is to transfer more fisheries management responsibilities to the groundfish industry. The transfer has not yet occurred, in part because of legislative limitations but also due to the inability of some segments of the industry to accept greater responsibility. In the absence of assurance that industry can and will accept increased responsibility, we are concerned about the potential impacts on conservation as a result of reductions and planned changes to the Department's groundfish management activities.

Human Resources Development Canada — The Atlantic Groundfish Strategy

Chapter 16 - Main Points

16.1 The accountability framework for The Atlantic Groundfish Strategy (TAGS) has significant weaknesses that have had an impact on the value obtained for money spent. These include the following:

- D the responsibilities of the organizations charged with developing and implementing TAGS were not clearly defined or agreed upon in a memorandum of understanding;
- D no overall strategic plan was established to identify and schedule the activities of the organizations responsible for implementing TAGS and to determine the indicators and performance expectations to be used, monitored and reported on;
- D no formal co-ordination mechanism was envisaged, even though TAGS involved joint activities because of its interdependent components; and
- D the information submitted to Parliament did not make it possible to determine progress toward TAGS objectives of restructuring Atlantic Canada's fishing industry to make it economically viable and environmentally sustainable.

16.2 The timetable for developing an initiative as important as TAGS was unrealistic. It was not geared to the restructuring of the industry. The funds (\$1.9 billion) were distributed according to a preliminary strategy, but subsequently had to be reallocated among TAGS components because of major changes to the initial strategy and because forecasts of the eligible population had been too low.

16.3 The information needed to assess participant eligibility was not always available. Because clear, accurate information was difficult to obtain, decisions were made on the basis of incomplete information that did not meet the requirements of TAGS eligibility criteria. Errors in applying the criteria were noted from the time TAGS was implemented, and many corrections had to be made. Varying interpretations of the eligibility criteria resulted in different treatment of participants in various areas.

16.4 The results of the labour adjustment component of TAGS will not be known. Program evaluation efforts were abandoned when the Strategy changed from an active participation strategy to a passive one. We are concerned that the information gathered and the lessons learned during an initial evaluation of program development and implementation may be lost and that results will not be accounted for.

16.5 The government proposes to review the longer-term issues arising from the elimination of TAGS foreseen in May 1998. We urge the government to examine carefully the consequences and impacts of the decisions made under TAGS in order to benefit from the valuable lessons that can be learned.

Human Resources Development Canada

A Critical Transition toward Results–Based Management

Assistant Auditor General: David Rattray
Responsible Auditor: Louis Lalonde

Chapter 17 - Main Points

17.1 Human Resources Development Canada has begun a transition toward results–based management. To this end, it has instituted a number of initiatives, including the publication of its *Results–Based Accountability Framework*, consultation with employees, and establishment of performance measures for major activities. The Department has also extended the application of these performance measures to activities carried out jointly with its partners. Overall, the roles and responsibilities of the partners are well defined. Also, the new Labour Market Development Agreements generally include the elements that are essential to good accountability among partners.

17.2 Certain steps remain to be taken to complete this transition. The Department needs to strike a suitable balance among the effectiveness, cost and quality of its services; at present, it does not analyze costs along with key performance indicators. It also needs to link performance to the consequences of having met or not met expectations.

17.3 The support of the employees working in the Human Resource Centres of Canada is essential if the Department is to successfully implement the Framework. The credibility of data on certain programs needs to be resolved within a reasonable timeframe. Employees need to have confidence in the reliability of the information, or the entire initiative may be jeopardized.

17.4 The information that Parliament receives on actual results compared with stated objectives is incomplete. We believe that, given the importance and the special nature of the Employment Insurance Account, it would be beneficial for Parliament if information were all in one place. There is no distinct report containing financial information on performance. Such a report could include, among other things, performance information, results achieved and actuarial analyses, which at present are not tabled in Parliament. Tabled actuarial analyses would improve the transparency and the availability of the data necessary for establishing an adequate reserve in the Account.

17.5 Our audit of two activities, management of accounts receivable and protection of program integrity, confirmed that progress has been made in results–based management. The Department has made major efforts since 1994 to integrate and harmonize the management of accounts receivable for all its programs. However, the quality of the portfolio of accounts receivable has deteriorated over the last five years. The performance of accounts receivable could be better measured, targeted and analyzed in order to assess the cost effectiveness of the Department's collection activities.

17.6 In activities for the protection of program integrity, results–based management is most advanced in the Employment Insurance Program. Since 1992, the Investigation and Control Directorate has been using information on results to negotiate resource levels and to set the national savings expectation. However, the other activities for the protection of public funds could be better measured and targeted in order to manage for results.

Revenue Canada and Department of Finance

Fostering Improvement in Tax and Trade Administration: Follow-up of Previous Audits

Assistant Auditor General: Shahid Minto
Responsible Auditor: Jim Ralston

Chapter 18 - Main Points

18.1 Over the last few years, Revenue Canada and the Department of Finance have made many changes to systems, procedures and practices that have strengthened tax and trade administration. Some of these changes are a result of the departments' own commitments to improving their operations; some changes were in response to reports of parliamentary committees; and other changes were made to respond to our observations and recommendations in reports on our value-for-money audits.

18.2 Our follow-up on previous recommendations found that progress is being made on a number of fronts. We encourage the two departments to continue their efforts to address the areas where concerns remain.

18.3 Revenue Canada is now making available more income tax advance rulings and GST rulings and interpretations and has taken steps to improve its documentation of key decisions leading to advance rulings.

18.4 The Department continues to have difficulty completing reviews of income tax returns selected for scrutiny during the annual processing program. It has expanded the number of processing review fields it is tracking, and it is maintaining year-to-year consistency in the fields chosen. Data quality improvements are expected to improve Revenue Canada's ability to analyze and evaluate the performance of the processing program.

18.5 The integration of collections for income tax, GST and customs and excise, the establishment of a risk analysis system, and changes in collection procedures are expected to enhance the collections function. A new procedure for early contact on large delinquent accounts is proving to be very productive, bringing in \$181 million in 1996-97. Revenue Canada has published guidance on applying the Fairness Package and has established a system to track its use.

18.6 The Department is shifting from an audit selection strategy focussed on identifying individual taxpayers to one focussed on industry sectors. It is also trying to take advantage of administrative consolidation to increase audit visibility and coverage. However, the Department still does not have a verification program aimed at RRSP contributions. Through improved reporting of social insurance numbers and sharing of data with other federal departments and provincial governments, Revenue Canada is improving its ability to pursue income tax non-filers and GST non-registrants.

18.7 It has developed a process to manage the risk associated with complex tax legislation, which can be a source of revenue leakage if provisions can be used for tax avoidance. It has also improved the collection and reporting of performance data across a number of its programs.

18.8 In trade administration, Revenue Canada's periodic verification initiative and country-of-origin audit program are expanding. The Department's small importer strategy has been formulated and implementation started.

18.9 With respect to tax assistance for retirement savings and income tax incentives for research and development, the Department of Finance has taken steps to provide improved estimates of program costs and to provide evaluations of program effectiveness. It has also taken steps to correct technical deficiencies in the law related to foreign affiliates and taxpayer migration.

Transport Canada

The Commercialization of the Air Navigation System

Assistant Auditor General: Shahid Minto
Responsible Auditor: Hugh A. McRoberts

Chapter 19 - Main Points

19.1 On 31 October 1996, in exchange for a payment to the Crown of \$1.5 billion, a substantial legislated monopoly in perpetuity for the operation of Canada's civil air navigation system was transferred to NAV CANADA, a private not-for-profit corporation created in 1995 to receive and operate the system.

19.2 Transport Canada did not fully segregate the air navigation system elements that were to be privatized before entering the sale process. It developed a number of estimates of the system's value, but did not obtain a formal valuation opinion from a qualified independent professional. Nor did it obtain any external assurance as to the reliability of the financial information and results on which it was basing its decision on the sale.

19.3 The Department used both going-concern and net book value approaches to valuing the system. Although the air navigation system was sold as a going concern, the Department reconciled the "purchase price" to a valuation of the system based on an "adjusted" net book value. In our opinion, that was not an appropriate method of valuation in these circumstances. "Due regard to economy" does not mean that the purchase price must equal the valuation; but it does mean that the value must be known and that any difference should be explained.

19.4 The government had directed Transport Canada to receive fair market value for the transfer of the air navigation system to a not-for-profit entity; the Department agreed to transfer the air navigation system for a negotiated payment of \$ 1.5 billion, approximately \$1 billion less than the entity's going-concern value of \$2.4 billion estimated by the Department's financial advisors.

19.5 The costs of transferring the air navigation system to the not-for-profit corporation were significant. Nevertheless, Transport Canada did not identify separately the cost associated with pension transfers, currently estimated at between \$145 million and \$275 million.

19.6 We are concerned about the Department's lack of justification for entering into a sole-source contract with its principal financial advisor.

19.7 We audited some elements of Transport Canada's oversight of the air navigation system. We did not audit the safety of the system and provide no opinion on it. We found that the legal and regulatory foundations for the regulation of NAV CANADA have been established and the Department has very recently approved its Policy Framework for the Safety Oversight of Canada's Air Navigation System. Nonetheless, there are important matters of risk, data, and audit and inspection that must be resolved before Transport Canada's regulatory regime can be said to be fully operating. The Department is aware of these issues and is in the process of drafting action plans and taking steps to deal with them.

19.8 We are concerned that until Transport Canada makes significant progress in implementing its performance-based regulatory regime, it will not be in a position to have full assurance of NAV CANADA's compliance with the safety regulations governing the air navigation system. Although it has indicated that it would be aware of any problems that existed, the Department has yet to conduct its first audit or inspection of NAV CANADA's operations.

Public Works and Government Services Canada

Privatization of the Canada Communication Group

Assistant Auditor General: Shahid Minto

Responsible Auditor: Alain Boucher

Chapter 20 - Main Points

20.1 The government made the decision to privatize the Canada Communication Group (CCG) and approved the sale process in April 1996.

20.2 The government's privatization objectives were to obtain best value for the sale of CCG, with minimum risk and liability for the government, and to minimize the impact on the printing industry while securing job continuity in the private sector for as many of its employees as possible. The government did not offer any guarantee of future business. However, to sell under the best conditions possible, it offered to prospective purchasers a business advantage, for a period of five years, in the form of privileged access to all government departments and agencies.

20.3 CCG was sold through a competitive sale process. The invitation to submit bids was made through the Open Bidding System. We found that the process was indeed open and attracted a significant number of bidders from the printing industry. The evaluation of offers received was conducted in accordance with the stated process and resulted in a proper evaluation of the bids. We therefore concluded that the offer submitted by the successful bidder, St. Joseph Corporation, represented the best value that could be obtained at that time under the conditions of sale specified by the government.

20.4 We found that there was satisfactory control over the transfer of assets and liabilities to the purchaser and that adequate revenue and expense cut-off procedures were used at the closing of the transaction.

20.5 CCG estimated the net cost for the divestiture of the organization at \$45.3 million. However, certain costs to be absorbed by other federal government entities as a result of the privatization were not included in this amount. Those costs included the waiving of about \$20 million to \$25 million of pension penalty costs for those who benefited from early retirement, and costs related to pension protection. The inclusion of the pension penalty costs alone would have brought the net cost of privatization to between \$65 million and \$70 million. In addition, the pension penalty costs were not included in CCG's analyses of the various future options for the organization. The inclusion of this cost element could have had an impact on the results of the cost/benefit analyses conducted.

20.6 We tested a sample of cases related to the Work Force Adjustment program established for CCG and found that they all complied with the conditions of the program. As well, we determined that the CCG program was comparable with the programs of departments and agencies subject to the Treasury Board Work Force Adjustment Directive.

20.7 We consider that the privatization process was well managed within the parameters set by the government; however, it is too early to predict whether this privatization will be a success in the longer term. Fairness to prospective purchasers and employees and jobs for employees were important criteria for the government, but resulted in costs (such as Work Force Adjustment costs) exceeding those that would have been incurred in a private sector transaction.

Household Goods Removal Services of the Federal Government

Assistant Auditor General: David Ratray

Responsible Auditor: Vinod Sahgal

Chapter 21 - Main Points

21.1 This audit was conducted in response to a request from the Standing Committee on Public Accounts.

21.2 Some 19,000 employees were moved by the federal government in 1995-96 — one quarter of all moves by the van lines in Canada and several times more than the next-largest Canadian employer. The federal government is well placed to obtain favourable terms from the moving industry.

21.3 The tariff paid by the government has been falling significantly in recent years. A number of factors have contributed to this decline, including introduction of the competitive bidding process in 1992. The tariff is below that paid by all but a few Canadian organizations procuring similar services. Nevertheless, there are a number of areas that warrant action.

21.4 The level of satisfaction of government employees with the quality of service was below that of relocated employees of other Canadian organizations. One reason is that emphasis has been placed mainly on obtaining the lowest price, not the “best value” — a concept based on both price and quality as measured in terms of employee satisfaction.

21.5 The existing contracting arrangements, which incorporate a formula for allocating business among qualified bidders, have proved to be brittle. For two consecutive years, problems have arisen in either the tendering or the implementation phase.

21.6 A potential exists for overcharging due to “weight bumping” as well as excessive weight for other reasons. The inherent risk that billed weights can be manipulated is high, yet controls to prevent this are weak.

21.7 The number and cost of personnel employed to administer household goods removal activities have not been falling despite the significant decline in volume of moves. Potential efficiency gains have been identified that could achieve savings of an estimated \$1.5 million yearly. Enhanced use of information technology, centralization, simplification of rules and regulations, and elimination of unproductive activities are some areas that need action.

21.8 There are other areas of potential cost savings. For instance, yearly savings of \$1 million to \$2 million in operating costs may be possible if a feasible alternative to weighing shipments can be found for pricing moves.

21.9 The employment of several former senior National Defence officials by the moving industry has created a perception of non-arm’s-length relationships. Further, a specific situation being looked at by National Defence may determine whether or not any abuse actually occurred.

Chapter 11

Moving toward Managing for Results

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Moving toward Managing for Results

Assistant Auditor General: Maria Barrados

Responsible Auditor: John Mayne

Main Points

11.1 Meeting Canadians' expectations for cost-effective programs requires that government managers focus on achieving results, especially benefits for Canadians. Basing decisions on results is vital as government reviews its involvement in program delivery and relies more on delivery by third parties. However, we found that managing for results is not widespread in government. In the past, managers have tended to focus on the resources they used, the activities they carried out and the procedures they followed.

11.2 A number of recent government initiatives support a focus on results, but concerted effort is required to bring about change. This study sought to support this change by drawing together experience from Canadian government programs and some other jurisdictions that have made significant progress. We selected examples for the study that illustrate different contexts and approaches.

11.3 We found cases where managers were measuring performance, communicating results information internally and externally and using the information to improve results. Managers of these programs were able to point to improvements in the key outcomes that they and their ministers were trying to achieve for Canadians. They also found that managing for results improved their management practices, program activities and programs' credibility.

11.4 The way managing for results is implemented will vary depending upon the situation of a particular program, but we found a number of consistent themes. Senior management leadership and commitment at all levels of government are particularly important. Effective managers create an organizational climate that encourages managing for results. Also important is agreement on the results to be expected and how to measure them. Although difficult to achieve, such agreement is necessary in order to focus activities and permit an assessment of progress.

11.5 Continued progress in managing for results will require ongoing leadership and attention across government. In particular, decision makers need to show that results count, by asking about results and visibly using them to make decisions.

Introduction

Results Focus Is Needed

11.6 In recent surveys, Canadians have said that they want public servants to focus more on the results to be achieved than on how things get done. They also want to be better informed of the progress that is being made and what they are getting for their tax dollars. The public is challenging government to spend less, yet is not willing to give up cherished programs or accept a lower quality of service. At the same time, government has been looking for ways to reduce the deficit, control debt and keep Parliament and Canadians better informed of the results of its programs. The government has also been examining its programs to determine where its involvement is most needed and to find more cost-effective means for their delivery.

11.7 Meeting the expectations of Canadians for programs that work and finding more cost-effective means of delivering them requires *managing for results*. When managing for results, ministers, senior officials, managers, staff, central agencies and Parliament make decisions based on what a program is achieving for Canadians — the results that citizens value — and at what cost. In particular, there is a focus on outcomes, that is, the benefits realized. Putting this approach into practice means agreeing on expected outcomes, measuring progress toward them, using the information and reporting results.

11.8 Canadians benefit from receiving better services and programs, ministers benefit from providing better value on things that matter to the electorate, and managers and employees benefit from greater satisfaction in serving the public well.

A better balance between managing inputs and results is needed

11.9 **Past emphasis on inputs and activities.** Holding managers accountable for results encourages them to focus more on results. In the past, managers were primarily held accountable for the prudent use of the resources they were given, the authorities they used and the activities they carried out. The concern was to ensure that spending was within budgets and complied with established rules and regulations. This did not encourage a focus on the results produced by these resources; rather, compliance dominated managers' attention.

11.10 Probity and prudence are important elements of the government's management framework, but more emphasis on accountability for results would allow the government to reduce unnecessary rules and regulations under which managers operate. This would give them greater flexibility to respond to their unique and changing circumstances. Increased accountability for results would encourage managers to give more attention to producing benefits for Canadians. A sensible reduction in rules and regulations would empower them with the authority to do so. This should be done without sacrificing attention to essential aspects of public sector management, such as due process and fairness.

The Time Is Right

11.11 Changing to a greater emphasis on results, particularly outcomes, is not easy. Past efforts in Canada and elsewhere have been only partly successful. Incentives within government have not always rewarded a focus on results. When following proper procedures is seen as paramount, when emphasis is on new spending priorities, and/or when managers are faced with repeated new budget reductions or freezes, attention tends to be focussed on resources used and activities undertaken. However, a number of recent developments in response to fiscal pressures

and the public's call for greater transparency and improved service have created a more supportive climate for a results focus.

Government is committed to managing for results

11.12 In 1995, the President of the Treasury Board, in his first Annual Report to Parliament, *Strengthening Government Review*, stated:

Our government is committed to delivering programs that work for the Canadian taxpayer. To better deliver programs and services, the federal Public Service must move from a culture of rules and processes to one that also focusses on innovation and results.

11.13 The government is emphasizing the need to strengthen the capacity of departments and agencies to manage for results. An action plan for doing so has been announced and progress has been reported in the annual reports to Parliament by the President of the Treasury Board.

A number of government initiatives demonstrate and support a results focus

11.14 Program Review. The government has undertaken a fundamental review of the programs and services it provides to Canadians, rethinking what the federal government should do and how best to do it. Some programs have been ended, and delivery approaches in others have been changed and rationalized. Direct program spending has been reduced significantly, with all programs under considerable pressure to spend dollars more wisely. Managers tell us that Program Review and the related expenditure reductions have forced them to focus on the continued value of the results they are striving to deliver to Canadians.

11.15 Better performance information for expenditure management. As reported in Chapter 5, Reporting Performance in the Expenditure Management System, the Canadian government has recently launched several initiatives to renew the system for planning and managing expenditures and reporting on results. All these initiatives directly or indirectly demand that departments set clear performance expectations, measure and report program performance, and use that information in managing programs.

11.16 Emphasis on service quality. Service quality is a tangible result that taxpayers have demanded and can immediately see. In 1990, with its public service renewal initiatives, the government announced its movement toward service standards, and confirmed its intentions in successive budgets. The public service *Declaration of Quality Service Principles*, issued in late 1995, affirmed the government's commitment to setting service standards. In September 1996, our chapter on service quality reported that implementation was slow. In response, later that year, the government publicly renewed its commitment to delivering high-quality service to Canadians. The establishment of service standards and reporting of progress toward their achievement are important dimensions of managing for results.

11.17 Alternative delivery mechanisms encourage a greater focus on results. The government's efforts to rethink the need for government intervention and to identify more cost-effective ways of delivering government programs have resulted in approaches that give a greater degree of independence to those delivering programs and that can involve third parties, such as private organizations and other levels of government, in delivery. These arrangements raise the issue of accountability for results, which is at times reflected in legislation or formal agreements, such as the legislation for the new Canadian Food Inspection Agency, federal-provincial agreements that give provinces more responsibility for employment training, and federal-provincial agreements for the Canada Infrastructure Works program. In partnership delivery arrangements, it is essential that all parties understand and agree on what results are to be accomplished with the new delivery arrangement, and know the extent to which the results are being achieved. Focussing on results can help overcome interorganizational barriers and help identify innovative approaches.

11.18 Information technology makes managing for results more feasible. Greater use of information technology makes it easier to collect and report on results information. Being able to easily compare information from different sources helps managers focus their activities more effectively.

Many other governments are changing to a focus on results

11.19 The Canadian government is not alone in encouraging a greater focus on results. Initiatives in other countries demonstrate that efforts to address fiscal pressures and improve service quality through managing for results are worldwide. Surveys and studies of the Organization for Economic Co-operation and Development (OECD) have noted that an orientation toward results and outcomes is evident in many OECD countries, including Australia, Finland, Norway, Sweden and the United States.

There is enough experience to identify lessons learned and best practices

11.20 The lessons learned in past Canadian efforts, as well as those of other jurisdictions, can be used as a springboard for further progress. As we observed in our audit on reporting performance, moving to a more results-based approach requires education and training. In particular, there is a need to communicate best practices and lessons learned. Experience in other jurisdictions and in some Canadian government programs is sufficient to begin an assessment of what has been learned. This study seeks to draw on that experience.

Focus of the Study

11.21 Managing for results is not widespread in government, and initiatives focussing on a more results-based approach to management are relatively recent. As a result, we concluded that a study that sought to draw together experience to date and clarify expectations would be useful at this time. The purpose of the study was:

- to propose and explain a management framework for encouraging greater progress toward managing for results;
- to identify lessons learned and best practices in moving toward managing for results; and
- to determine incentives and disincentives faced by departments and program managers in adopting a results-based management culture.

11.22 In this chapter, we start by setting out the framework, then discuss it in more detail, illustrating it with examples of best practices and lessons learned, and pointing out incentives and disincentives. See **About the Study** at the end of the chapter.

11.23 Cases included in the study. Our study sought programs that showed some federal experience in managing for results or that were well advanced in moving in that direction. We identified four such programs. We also examined one department that had been moving in this direction for a number of years. There may be other departments and programs that could also have served as examples of progress. We did not carry out a survey across government to find these illustrative cases, but sought them out through less formal inquiry.

11.24 The four programs are:

- **North American Waterfowl Management Plan (NAWMP).** The Plan is intended to address the decline in population of waterfowl in North America. It is a partnership program administered jointly through the International Plan Committee (U.S./Canada/Mexico), and implemented and funded through regionally based joint ventures involving federal, state, provincial, non-governmental organizations and the private sector. From 1986 to 1996,

actual contributions toward the Plan activities in Canada totalled about \$360 million, with almost half coming from the U.S. (U.S. partners contributed over \$172 million, Canadian provinces \$80 million, Canadian federal government \$59 million, private sources \$49 million).

- **Canada Centre for Mineral and Energy Technology (CANMET).** This federal government laboratory, part of Natural Resources Canada (NRCan), has about 700 employees and a budget of about \$90 million to conduct and sponsor research for the economical, safe and environmentally responsible recovery and use of Canada's mineral, metal and energy resources.
- **Travellers Program.** This program of Revenue Canada's Customs Border Services is concerned with the international movement of people and their accompanying baggage as they enter Canada. It has almost 2,600 employees and budgeted expenditures of approximately \$113 million.
- **Investigation and Control (I&C).** I&C is part of Human Resources Development Canada. It employs approximately 1,100 employees and uses a budget of about \$55 million to prevent, deter and detect abuse and fraud by claimants of the Employment Insurance program. This chapter focusses on the I&C function. We did not assess the management of I&C activities bearing on other programs than Employment Insurance. Overall departmental progress in managing for results is reported in Chapter 17 — Human Resources Development Canada — A Critical Transition toward Results-Based Management.

11.25 We also examined one case where the whole department was moving toward managing for results.

- **Department-wide accountability framework in Environment Canada.** Environment Canada, with approximately 4,600 employees and expenditures of over \$546 million, has developed a framework that describes the results expected from its three business lines. The Department has put in place a number of processes for implementing the framework.

11.26 Finally, we also examined several cases in the United States where progress has been made in managing for results.

11.27 Definitions used. The **results** of government programs are the products and services provided by these programs and the benefits and other effects that they produce. Programs deliver two kinds of results: **outputs**, the direct products and services produced by government activities, such as an Employment Insurance cheque or some requested information; and **outcomes**, the intermediate and long-term effects of those outputs on individual Canadians and our society.

Findings

A Framework for Managing for Results

11.28 The 1995 report to Parliament by the President of the Treasury Board states,

“the government is committed to

- defining the results it wants to achieve;
- giving managers the resources, tools, information and guidance to achieve these results; and

- measuring and demonstrating actual achievements.”

11.29 It goes on to identify three key actions for implementing this commitment to managing for results, namely identifying visible results, improved management of results measurement and improved performance reporting. These themes were reiterated in the 1996 President’s report.

11.30 This structure for managing for results is consistent with our review of relevant literature and experiences in other jurisdictions and in Canada. This review suggests that organizations that successfully manage for results:

- foster an organizational climate that encourages managing for results;
- agree on expected results;
- measure actual results to improve performance; and
- effectively report performance.

11.31 The last element is covered in Chapter 5, which examined reporting performance to central agencies and Parliament. This study examines the first three elements. Exhibit 11.1 outlines the elements of the framework and the following discussion elaborates further on them.

Exhibit 11.1

A Framework for Managing for Results

The purpose of managing for results is:

- to achieve effective or improved performance in terms of the intended results, especially outcomes, being achieved by a program in relation to the costs incurred; and
- based on empirical evidence, to learn about the program, its performance and the outside factors to adapt the program in light of past performance and its changing environment.

Managing for results requires:

1. Fostering an Organizational Climate That Encourages Managing for Results

Fostering an appropriate organizational climate is essential and requires:

- **Demonstrating commitment and leadership.** Commitment is demonstrable through such things as strong senior leadership, widely communicated mission statements, and effective guidance.
- **Using external and internal levers.** Interests in common with external partners, and external and internal pressures and events, are recognized and used to encourage a focus on results.
- **Creating supporting incentives.** Appropriate incentives are in place to encourage the measurement and use of performance information.
- **Building expertise.** Learning is supported through training, professional development and the sharing of experiences.
- **Developing a capacity to learn and adapt.** Learning from past experience, proactive monitoring of the environment and development of a capacity to cope with changing circumstances is encouraged.

2. Agreeing on Expected Results

Implementing managing for results entails agreement among program and departmental management, program staff, external partners and other key stakeholders on what outcomes the program is intended to accomplish in light of its mission and objectives, past experience and the external environment. This involves clarifying the terminology used to describe these concepts and includes the following:

- **Agreeing on outcome objectives.** Agreement is reached on a set of outcome objectives for the program, outlining what it is intended to accomplish in light of the organization's mission and objectives.
- **Agreeing on performance indicators.** Agreement is reached on a manageable set of qualitative or quantitative program performance indicators that relate to the agreed outcome objectives, and that will be used to assess and manage the program.
- **Agreeing on performance expectations.** Agreement is reached on a set of realistic and challenging performance expectations. Expectations are clear and concrete, relate to the outcome objectives and specify a time frame for their achievement.

3. Measuring Results to Improve Performance

Realizing benefits from managing for results requires:

- **Measuring and reporting performance.** Practices exist for collecting, assessing and reporting program performance and costs in terms of the indicators identified and agreed on.
- **Using performance information.** The performance information gathered and assessed is used to improve program performance.
- **Reviewing and updating indicators and measures.** Based on experience gained, changing circumstances and experience gained in similar programs elsewhere, the performance indicators, expectations, and measurement and communication strategies are periodically reviewed and improved.

4. Effectively Reporting Performance

Effective reporting to allow the reader to judge how well programs are doing requires:

- **Describing the context and strategies used.** The mission, mandate and objectives of the organization, the major strategies used and the related external context are discussed.
- **Stating meaningful performance expectations.** Clear and concrete key performance expectations are focussed on outcomes.
- **Reporting performance accomplishments against expectations.** Key accomplishments are related to expectations and are attributable, in whole or in part, to the activities undertaken.
- **Demonstrating the capacity to learn and adapt.** The ability of the program to learn from past performance and to adapt to external changes is demonstrated.
- Reporting fair and reliable performance information. Reported performance information is fair (understandable, relevant and balanced) and reliable (accurate).

Managing for Results Has Been Beneficial

11.32 Although the ways of implementing managing for results have varied, managers, in all cases, were able to point to benefits from adopting the framework.

Programs report improved outcomes for Canadians

11.33 The key benefit of a focus on results is better results. We found that the managers of the programs we examined were able to point to improvements in key outcomes they and their ministers were trying to achieve. In addition to program performance, many factors influence changes in outcomes. It is often very difficult to separate the contribution made by a program from that of other factors. Indeed, in most of our cases, departments pointed to other factors that may also have influenced results. We consider the recognition of other contributing factors to be a good practice; however, we did not attempt to determine the relative extent to which improvements in outcomes were due to program efforts or to other factors.

11.34 As shown in the example in Exhibit 11.2, the North American Waterfowl Management Plan reported securing and enhancing a large area of waterfowl habitat and can demonstrate a related growth in waterfowl populations. Favourable weather and rainfall have also contributed. Case 1 provides additional detail on how a community of common interests supported managing for this result and on how that community manages for results.

Exhibit 11.2

(This exhibit is not available, see the Report)

11.35 As another example, shown in Exhibit 11.3, savings to the Employment Insurance Account generated by Investigation and Control (I&C) activities at Human Resources Development Canada have increased significantly. I&C officials attribute the increase to refocused activities resulting from implementation of a savings performance indicator, and other factors, including increased resources, technological advances, and more severe penalties. Factors contributing to the implementation of this key indicator, and the implications for the I&C function, are described in Case 2.

Exhibit 11.3

(This exhibit is not available, see the Report)

11.36 As shown in Exhibit 11.4, managers of the Travellers Program reported that the percentage of travellers complying with laws and regulations on the importation of goods and the payment of taxes and duties has increased. Program officials believe that this increase comes from the use of information on results to focus activities better and from public communication of their refocused efforts. In their view, refocussing their activities has improved compliance by making enforcement efforts more visible to travellers and by encouraging greater traveller co-operation through reducing the frustration that accompanies long wait-times at the border. Officials recognize that other factors have also played a role in increased compliance, including increased personal exemptions and declines in cross-border shopping. Case 3 describes how traveller compliance and satisfaction became issues that supported a transition to managing for results in the Travellers Program.

Exhibit 11.4

(This exhibit is not available, see the Report)

Progress in improving performance in other jurisdictions

11.37 Other jurisdictions that have adopted managing for results have also reported improved performance. In the United States, a 1997 General Accounting Office status report on the early stages of implementation of the *Government Performance and Results Act* found limited, but substantial, examples of short-term program improvements. The United States Coast Guard re-examined its mission and shifted the focus of its marine safety program from regulation to one that includes education, thereby contributing to a significant decline in the marine towing industry fatality rate. Case 4 illustrates how the United States Coast Guard manages for results, as a specific example of progress in another country.

11.38 The U.S. Veterans Health Administration reported the use of performance information to target the most important opportunities to improve health services to veterans. This practice has lowered the mortality rate for cardiac procedures by an average of 13 percent over the last eight years.

Establishing credibility

11.39 In addition to improving results, managing for results can provide a number of other benefits. One key benefit is enhanced external credibility of an organization. In 1994, CANMET reported the results of a selected sample of research and development projects in *An Investment in Canada*, which has been widely distributed inside and outside Natural Resources Canada. Its measurement of the results of research and development projects has led to external recognition in this field. Case 5 describes how managing for results was a CANMET manager's response to the need for credibility with external partners.

11.40 At Environment Canada, the development of a corporate accountability framework provides managers with the opportunity to demonstrate to others their achievements and how they contribute to meeting the Department's

long-term objectives. Case 6 describes how collaborating within a corporate framework for managing for results benefits managers at Environment Canada.

Putting the Framework into Practice

11.41 Although the cases that we examined collectively exemplify the characteristics set out in the framework, none represents all of them, nor did we expect them to. There are many ways of managing for results, and it is reasonable that managers focus on those approaches that are most appropriate to their situation. Examples were chosen because they illustrate particular points clearly or show variations in approach or context.

Fostering the right organizational climate

11.42 In order for benefits to be realized, the organizational culture has to support managing for results. Changing to a greater emphasis on results usually requires significant changes in the existing culture. There will likely be resistance to needed changes and thus they will take time and real effort to bring about. Experience has suggested a number of organizational factors that foster this culture:

- demonstrating commitment and leadership;
- using external and internal levers;
- creating supporting incentives;
- building expertise; and
- developing a capacity to learn and adapt.

The stronger the presence of these factors, the greater the chance that managing for results will take hold and be effectively implemented.

11.43 The right climate for managing for results can be fostered at all levels of government. Credible government-wide support will encourage a focus on results, and a supportive corporate culture in a department will reinforce efforts of program managers, as in the case of Environment Canada.

11.44 Our study focussed mostly on the program level, where support is essential. As we noted in the Introduction, a number of initiatives, either government-wide in scope or supported by the central agencies of government, are contributing to the creation of a government-wide climate for managing for results. Exhibit 11.5 depicts the important organizational factors that encourage and support managing for results.

Exhibit 11.5

(This exhibit is not available, see the Report)

11.45 Strong senior-level leadership and continuing commitment. Managing for results takes hold when senior management visibly supports the approach and is poised to take advantage of opportunities to move toward a focus on results. Our cases and the review of experience of other jurisdictions suggests that senior management commitment and leadership is the most common and perhaps most important feature of successful managing for results. We found strong leadership shown through such actions as:

- ensuring that the organization's mission (or the program's strategic objectives) focusses on results and is accepted and communicated broadly;
- ensuring that progress in implementing managing for results practices is a key part of performance appraisals of managers (or staff);
- supporting experimentation and innovation;
- leading by example;
- visibly and regularly assessing progress being made toward managing for results;
- demonstrating sustained interest and personal involvement in the results management initiative;
- including performance expectations in managers' accountability accords or performance contracts, and using these documents in the annual performance appraisals of managers; and
- entering into partnerships with other departments, governments and non-governmental organizations to pursue a common interest in results.

11.46 Managing for results is not without risks. In the words of the Clerk of the Privy Council, "Ministers and senior officials must accept some of the uncertainty implicit in giving up a degree of control ... [in moving] from the comfort of process to a commitment to results." Moving from the comfort of process requires considerable leadership support if managers are going to focus more on results.

11.47 Senior leadership was a particularly important element in our cases. A senior manager at CANMET initiated the focus on managing for results and actively sustained it over a number of years. The focus on managing for results in the Travellers Directorate was led by the efforts of the senior managers involved. In both cases, strong and persistent leadership was needed to overcome resistance to the approach.

11.48 Using external and internal levers. External and internal factors or events that arise can be used by committed managers as levers to encourage an organization to focus more on results. In the case of the North American Waterfowl Management Plan, a common interest in waterfowl and wetland conservation has brought a variety of parties together. It was consensus on desired results and the shared vision that allowed the Plan partnership to be formalized. At CANMET, a senior manager brought in to make the program more relevant to industry turned to managing for results as the approach.

11.49 The need to rationalize activities as part of restructuring and reorganizing can also create opportunities, although this was not the case in the Canadian programs we studied. However, to make use of the opportunities that these factors create, management has to recognize and be prepared to respond to them. The organization also needs the capacity to respond, which includes appropriate supporting incentives, expertise and adaptive capacity.

11.50 Supporting incentives. Traditional budget-driven and process-oriented management practices may be resistant to change because of the existing incentive structure. As suggested earlier, incentives in the past have often run counter to efforts at measurement and a focus on results. In CANMET, for example, resistance was encountered due to the traditional scientific incentives based on publication frequency. As well, resistance to specific results approaches adopted may arise from a conflict within an organization between goals, such as service and financial goals. This was the case in the Employment Insurance (EI) program at Human Resources Development Canada, where generating savings to the EI Account was not seen by some staff as consistent with working to increase the employability of clientele. Overcoming these sources of resistance requires attention to existing incentives, both

tangible and intangible, and the development of incentives that support managing for results. We found that a variety of incentives can be used, including:

- ensuring that managers (or staff) are provided at least annually with an occasion to demonstrate what their programs have accomplished. For example, CANMET, Investigation and Control, and the Travellers Program use accountability accords as incentives. These agreements between levels of management specify the results to be achieved by managers over a certain time frame and are used in reviews of the manager's performance;
- providing needed management flexibility to program managers (or staff) to allow them to move toward managing for results. In CANMET, managers are given increased authority in return for being accountable through accountability accords for achieving performance expectations;
- supporting programs that supply good performance information. The Treasury Board Secretariat has supported Investigation and Control efforts to generate savings to the Employment Insurance Account by allocating resources tied to performance targets; and
- encouraging the development of intangible incentives in the organization (or program), such as recognition or rewards for managing for results.

CASE 1: MANAGING FOR RESULTS IN THE NORTH AMERICAN WATERFOWL MANAGEMENT PLAN (NAWMP)

The North American Waterfowl Management Plan (NAWMP) is an international waterfowl and wetlands conservation program designed to restore waterfowl populations through securing, enhancing, and managing wetlands and uplands habitat. Signed by Canada and the United States in 1986, it established a 15-year framework for international co-operation for the preservation of migratory birds. In 1994, the Plan was reviewed and the original commitment expanded in the *1994 Update to the North American Waterfowl Management Plan*. At the same time, Mexico signed the Update and became a full partner. Initially conceived of as a "duck plan", the NAWMP is now recognized by signatories to the Plan as contributing to broader goals of biodiversity conservation, sustainable development, and integrated resource management. From 1986 to 1996, actual contributions toward the Plan activities in Canada totalled approximately \$360 million, almost half coming from the U.S. (U.S. partners contributed over \$172 million, Canadian provinces \$80 million, Canadian federal government \$59 million, private sources \$49 million).

Concern over declining waterfowl populations led to managing for results. Partnership organizations and individuals in the three countries co-operate to deliver conservation in high-priority habitats throughout the continent. Waterfowl are enjoyed by many people, including diverse groups such as sports and subsistence hunters, naturalists, conservationists, tourists and other members of the public. Altogether, these people spend millions of dollars on their interest in waterfowl. The NAWMP was drawn up to address this community of interests' concern over the declining populations of waterfowl in North America caused by years of drought in the Prairies and loss of habitat resulting from the conversion of wetlands for agriculture, industry and urbanization.

The Plan's focus on managing for results is demonstrated by its stated objective to restore waterfowl populations through securing, enhancing and managing wetlands and upland habitat. To achieve this objective, the Plan sets habitat goals for the number of wetland and upland habitat hectares that need to be conserved in North America to recover waterfowl populations to levels recorded during the 1970s. Performance expectations are specified in terms of quantified targets to be achieved by the year 2000.

Several incentives support the Plan's managing for results. The activities under the Plan are co-ordinated by the NAWMP International Committee, made up of members from Canada, the U.S. and Mexico. The Committee consists of a Co-Chair and five members from each of the three countries. The Canadian Co-Chair is the Director, Wildlife Conservation Branch, Canadian Wildlife Service from Environment Canada. Two national councils (Canadian and American) direct project selection and funding.

The key strategy of NAWMP for managing for results is to work through a partnership of stakeholders in the form of regionally based habitat and species Joint Ventures (JVs). These JVs involve federal, state, provincial and territorial government agencies; non-governmental organizations (NGOs); the private sector; and landowners across the continent in co-operative habitat management efforts. Partners, motivated to secure, enhance and manage habitat for different reasons, come together under JVs to achieve results that would be difficult or impossible to do individually.

Joint Venture partners have succeeded in involving private landowners in wildlife conservation, and have worked with industry and local governments to maintain wetland habitats. Partnerships are also with NGOs that provide essential funds and mechanisms necessary for

the implementation of the JV objectives. The innovative and partnership-oriented nature of the JVs is a major reason for the success of the Plan's managing for results.

Performance objectives and results are periodically reviewed. Important in managing for results is the need to review the indicators used and the performance targeted. The NAWMP is kept current through periodic reviews of the results achieved at both the continental and Joint Venture levels. The 1994 Update re-examined the Plan thoroughly and expanded its commitment. The population goals and habitat objectives were reviewed and revised as warranted to suit present conditions. New policy and strategic initiatives were identified to strengthen the Plan. A 1998 Update is currently in process and will be released in summer 1998.

Review efforts support the Plan's managing for results. As part of a continuous learning process, research studies of waterfowl species and habitats are carried out to improve conservation methods. The biological assumptions upon which habitat objectives and conservation strategies are based are tested for validity. Program evaluation techniques are used to provide more reliable assessments of conservation projects, and to better understand the dynamics of waterfowl populations. In addition, on the recommendation of the NAWMP Committee, a Continental Evaluation Team was formed to develop a strategy and answer basic questions about assessing the accomplishments of NAWMP biological programs. The Team has proposed management initiatives and frameworks to address some institutional and technical challenges that face the NAWMP in the coming years. All this review effort supports NAWMP's managing for results.

Results have been achieved. Management believes that the Plan's managing for results has been successful. After 10 years of operation, it has had a significant impact. In Canada, as of 1996, the Plan partners had conserved and enhanced over half a million hectares of wetland and other habitat, and indirectly influenced improvements to another two million hectares. Waterfowl numbers have greatly increased, with a 1996 estimate predicting a fall flight of 90 million ducks, an increase of 30 million in the last two years and 35 million since 1985. Favourable weather and rainfall have also contributed to the growth in waterfowl populations.

The NAWMP shows how a number of diverse partners with common interests and a shared vision can work together to manage for a common result.

CASE 2: MANAGING FOR RESULTS IN INVESTIGATION AND CONTROL — HUMAN RESOURCES DEVELOPMENT CANADA

Investigation and Control (I&C) is one of the six service lines of the Employment Insurance Income Benefits business line of Human Resources Development Canada (HRDC). Its activities use the equivalent of approximately 1,100 employees and budgeted expenditures of about \$55 million. One of the principal objectives of the Department is to protect public funds against fraud and abuse by assuring, among other things, that payments are made to those and only those who have the right to them. The I&C function is one of the mechanisms used by the Department to protect the integrity of the Employment Insurance Account. It contributes to this objective by investigating probable and potential abusers and ensuring that employees and claimants issue correct and timely information.

Measuring and reporting the performance of I&C activities have been ongoing. Prior to 1992, there were a large number of I&C performance measures that were, for the most part, activity—and productivity—based. Performance was measured on the basis of efficiency (investigations completed and investigations completed per productive full-time equivalent), rather than on the extent to which these activities contributed to the overall objective of protecting the Account against fraud and abuse. Management believed that these measures led to a focus on inputs and activity levels rather than protecting the EI Account from fraud and abuse.

In April 1992, Investigation and Control management introduced savings as an indicator to measure the extent to which its activities protected the integrity of the EI Account through preventing, deterring and detecting fraud and abuse. This change was implemented in order to shift the focus from managing I&C activities to managing the outcomes of their activities. In effect, management began to manage for results.

Several factors contributed to the move toward managing for results. This shift in focus was set in motion by a number of developments that created a receptive environment. A departmental shift in priority to focus on re-employment measures required both a redirection and increase in funds. As well, the climate had become more conducive to zero tolerance with respect to fraud and abuse. Stricter penalties were being imposed by I&C policy and later by the new *Employment Insurance Act*. In addition, improvements in information technology permitted the introduction of new I&C initiatives.

The focus on increased detection and prevention of fraud and abuse was facilitated because a directly related indicator had already been implemented, although it had not yet been used to monitor performance. From this point on, however, I&C's amount of total savings achieved has been the key performance indicator for I&C activities. As well, each year I&C resource levels and total savings objectives have been negotiated between the Treasury Board Secretariat and the Department, leading to the establishment of a new base level of I&C resources. The linkage of resources to a savings objective has contributed and is fundamental to managing for results in I&C.

With resources being tied to a results-based indicator, there is a built-in incentive to manage for results, sending a clear message to Investigation and Control management and staff. It has encouraged managers and given them the flexibility to plan for and pursue the appropriate mix of prevention and detection activities appropriate to each region or local area and to discover new initiatives that contribute to protecting the EI Account against fraud and abuse, for example, examining suspicious Records of Employment before a claim is established.

While Investigation and Control has been in the forefront of managing for results within HRDC, recent commitment by senior management to a departmental results management framework has provided further momentum to I&C's ongoing efforts.

Results have been achieved. Detection and prevention of fraud and abuse of the EI Account have significantly increased over the past five years — as measured by total savings — from \$390 million to \$560 million. A shift to results-oriented management does not alone account for this increase. The increase in I&C dedicated resources and legislative amendments that strengthened penalties also contributed. However, management believes that managing for results, by leading to better focussed I&C activities, has indisputably contributed to the overall objective of protecting the EI Account.

Reporting results contributes to the Department's credibility. The measurement and reporting of the savings achieved, along with I&C's objectives, have permitted I&C to demonstrate accountability both within and outside the Department. The activities of I&C have become more transparent and are potentially more justifiable, which helps to enhance I&C's credibility as it seeks to maximize its potential to detect and prevent fraud and abuse in light of the inherent political and social sensitivities.

Management says that Investigation and Control will continue to develop expertise and databases to provide the information required for good results management decisions and to maintain the credibility of the performance measurement system.

CASE 3: MANAGING FOR RESULTS IN THE TRAVELLERS PROGRAM

The Travellers Program is part of the Customs Border Services (Customs) business line of Revenue Canada. Its activities use approximately 2,600 employees nationwide and budgeted expenditures of about \$113 million. Through this Program, the Travellers Directorate is responsible for the international movement of people and their accompanying baggage as they enter Canada.

The present system of the Travellers Program for managing for results has evolved over several years and is based, to a certain extent, upon the experience gained through trial and error. As far back as the early 1980s, Customs had attempted to implement performance indicators as part of government-wide initiatives such as Management by Objectives, Operational Performance Measurement System, or Policy and Expenditure Management System. These initial indicators were intended to report on daily operational effectiveness. Department officials interviewed stated that the system designed at that time was too broad and attempted to measure too many things at once. In hindsight, the indicators were too numerous, the traveller sample groups were not selected in a meaningful way and the system should not have relied on the field managers to carry out the sampling.

Senior management at headquarters was committed to the concept of measuring performance, but the field management and staff, who had to do all the work, believed there was very little in it for them. The system was too ambitious, too complicated and soon became unreliable due to poor data quality. It became neglected and eventually was abandoned.

A crisis in border non-compliance was key in moving toward managing for results. Interest in performance measurement was renewed when record numbers of Canadians began doing their everyday shopping in the U.S. The number of same-day trips to the U.S. by Canadian residents jumped from 43 million in 1989 to almost 52 million in 1990. This generated millions of new transactions for the collection of duty as well as long line-ups — up to eight hours — especially on weekends. The view of departmental officials is that the sheer volume of travellers placed great pressure on routine operations at many land border crossings. Rather than waiting in long lines of returning shoppers to obtain customs clearance, travellers began leaving Customs offices without paying duties or taxes, fuelling a surge in non-compliant behaviour.

Revenue losses were significant and Customs became the focus of national media attention. Politicians called for action. To respond effectively, the Travellers Directorate needed to know how and where to focus its finite resources and to determine which travellers required more in-depth customs examinations. It also needed reliable information about the amount of smuggling taking place and where it was occurring. According to departmental staff, this tremendous challenge initiated the re-engineering of the Travellers Program.

Facing these operational difficulties, the Travellers Directorate turned to the lessons learned from implementing the previous system and introduced, at first on a very small scale, the "stint" performance measurement (sampling) system. It was given the name "stint" since teams of field staff are temporarily assembled for five days at a time to conduct performance measurements of the border offices. The

system started in 1991 with a single indicator, *compliance rate* — the percentage of travellers who voluntarily comply with the laws governing entry in Canada. Measurement was carried out by the sampling teams under the full-time supervision of headquarters. This approach was born in response to “real and immediate” operational needs and a demand for service that gave managers at all levels a strong vested interest in obtaining credible results. Managers believe the approach proved successful because results pointed to areas where resources should be focussed. The measurement system was expanded in 1992-93 to include all major land border offices and a baseline was established from which to gauge improvement. Major airports were included in 1994-95. The system provided a quantitative insight into performance at the border office level, as well as regionally and nationally, that was comparable over time.

The commitment and leadership of senior management was critical. Departmental staff interviewed indicated that successful implementation depended upon the leadership, commitment, and hands-on involvement of the senior managers. Even before the present system, they had been strong consistent advocates of performance measurement. Currently, they use compliance results to guide decisions about how to adjust activities in collaboration with the managers being measured, as well as to publicly point to the contribution of Customs. They are persistent in their efforts to spread the acceptance and use of these performance measures. The assistant deputy minister (ADM), Customs, actively “markets” managing for results with other ADMs, as well as regularly emphasizing its importance with all levels of staff during training sessions.

With the encouragement of government-wide service standard initiatives to improve service quality, the “stint” system was refined and expanded to include additional indicators. In 1993, the Travellers Directorate developed indicators to measure *client satisfaction* and *wait-times* for travellers. The information and feedback obtained through this process has led to many improvements in service, including the design of facilities to reduce wait-times and new information pamphlets to facilitate voluntary compliance.

CASE 3: MANAGING FOR RESULTS IN THE TRAVELLERS PROGRAM (CONT'D)

Accountability contracts contribute to linking long-term objectives to indicators. In 1996, Customs took another step. It embarked on a joint planning process with the regions to produce accountability contracts between the ADM, Customs, the (six) regional ADMs, and the respective regional directors. The accountability contracts link the long-term objectives to indicators and goals for headquarters and the various regions of the Department. Expected performance for the fiscal year is stated and is the subject of discussion and input from field staff. Although accountability contracts were not required within the regions, three regions established additional accountability contracts with the next levels of authority to obtain the commitment of district managers, port managers and chiefs (see Exhibit 11.6). The Department intends to continue the process, with improvements to allow the contracts to be used as a basis for performance appraisals.

Environment is changing. Travellers Directorate indicates that present volumes are manageable and it has a good report card from the public. But there are signs of deterioration at major sites, indicated by increased client dissatisfaction and wait-times, as a result of growing casino traffic and increasing flight arrivals under the *Open Skies Agreement*. At certain sites, the current Primary Inspection Line (PIL) system design has been stretched to the limit. The management of the Travellers Program recognizes that current service and compliance levels will not be sustainable at high-volume sites in the future, and that it must accelerate its re-engineering initiatives.

Important lessons have been learned in managing for results. The management and staff of the Travellers Directorate indicated that they learned important lessons. First, it is critical that senior management proactively promote managing for results with hands-on involvement. Second, the focus must be on only a few key indicators that are simple and easy to understand in relation to operations. Next, the indicators must be measured objectively and credibly and, in particular, managers should not measure their own performance. Finally, the disruption of measuring the performance of operations must be minimized, ensuring that it is not a burden on those delivering the program.

Exhibit 11.6

(This exhibit is not available, see the Report)

CASE 4: MANAGING FOR RESULTS IN THE UNITED STATES COAST GUARD

Performance reporting is legislated. Under the 1993 *Government Performance and Results Act (GPRA)*, the United States federal government initiated several pilot projects, one of which involved the Coast Guard's Office of Marine Safety and Environmental Protection.

The starting point for the Office of Marine Safety and Environmental Protection, in 1992, was an organizational assessment that showed that overly centralized management, based on optimizing outputs, was frustrating the attainment of desired outcomes—notably, saving lives. Among the outputs emphasized were activity-based performance measures, such as the numbers of vessels inspected and certified.

Strong leadership was key. With strong leadership from a senior manager, a new planning framework was developed. The first business plan articulated key performance goals over a five-year period, and performance indicators. An example of a performance goal

for marine safety is to reduce accidental deaths and injuries from maritime casualties by 20 percent over five years; the corresponding performance indicators are worker fatalities per 100,000 workers, and non-worker fatalities per billion tons of commerce.

Emphasis was placed on risk management; the main use of performance information is to affect the outcomes themselves. By disaggregating high-level measures, like worker fatalities and passenger-vessel casualties, the Coast Guard has begun using trend and risk information to redirect activities and resources toward goals. Through better communication of results to field staff, and risk assessment training, performance information is combined with local knowledge to identify approaches to reducing risk. In particular, partnerships with local stakeholders have helped to improve results and better target resources.

Performance information is being used. Performance information is being used in a variety of management and decision processes, including the development of a multi-year budgeting strategy.

Lessons were learned. The Coast Guard has rescinded all performance standards that were not mandated by statute or other formal requirement, thereby enhancing managerial flexibility by the equivalent of 0.5 million work hours annually (8.5 percent of direct program staffing).

The Coast Guard is extending the GPRA pilot to cover all of the operating programs of the agency. Among the lessons and challenges from the experience to date are:

- the importance of the personal involvement of senior line managers;
- the need to fundamentally rethink programs: not about what you do, but about why you exist;
- the need to extend outcome goals and indicators beyond what the agency controls—an ongoing issue is to establish firm linkages between activities and outcomes;
- the value of setting challenging goals;
- the importance of performance measures being relevant to senior management, and usable in managing activities and resources;
- the challenge of further extending managerial flexibility, which is inherent (and necessary) in the process and one of the strongest incentives; and
- the proof of successful managing for results is whether things are getting better in the real world. For example, the focus on saving lives led to measures to deal with high fatality rates in the towing industry, which has contributed to a significant decline in those rates.

Source: U.S. Coast Guard. Using Outcome Information to Redirect Programs: A Case Study of the Coast Guard's Pilot Project under the *Government Performance and Results Act*, 1996.

CASE 5: CREATING A CLIMATE FOR MANAGING FOR RESULTS AT THE CANADA CENTRE FOR MINERAL AND ENERGY TECHNOLOGY (CANMET)

CANMET is a research and technology development arm of Natural Resources Canada (NRCan), with about 700 employees and an annual budget of about \$90 million. Through its research facilities across Canada and its funding programs, CANMET works with the minerals, metals and energy industries to find safer, cleaner and more efficient methods to develop and use Canada's mineral and energy resources. Prior to reorganization, CANMET was a single entity consisting of both energy and mineral technology. In 1995, CANMET was split into two sectors — the Energy Technology Branch and the Mineral Technology Branch.

Senior management leadership was key. As a primary technology developer, CANMET had little direct impact on the marketplace for technology. Its market impacts came from third party investment and marketing of CANMET's technologies. Managing for results began in 1987 after the arrival of a new assistant deputy minister (ADM) who was brought in to make CANMET more relevant to industry. In response to pressure from industry, cost-conscious and results-oriented management practices were progressively adopted in the fields of energy, minerals, and metals science and technology. A supportive organizational climate to manage for results came from CANMET's increased reliance on partnership and consortium arrangements with private sector companies. Such alliances with the private sector have encouraged CANMET to adopt the businesslike and results-oriented approach of its industrial partners to secure their confidence, to have a compatible working relationship with them, and to provide major benefits to research and development (R&D).

According to management, prior to the new ADM's arrival, the main measure of individual performance was the number of scientific publications produced. Key performance indicators focussing on the benefits to industry were developed to demonstrate achievement of results. Mid-year and year-end reviews of accomplishments were also emphasized. Adopting a more businesslike approach included preparing CANMET's first Business Plan in 1987, and a Corporate Plan in 1990. By 1990, CANMET was very much involved in impact measurement, which attempted to establish the value of the organization to industry.

CANMET's senior management continues its commitment. In selecting research and development projects, a greater emphasis is placed on the potential for commercial application of technologies as well as their potential for achieving the intended socio-economic benefits. Recovering CANMET's R&D costs is considered in reaching project agreements with industrial partners. CANMET has formed many alliances and partnerships with industry, other federal departments, provincial governments, universities and international agencies to share the costs and risks of research and development. The Department believes that such alliances ensure that Canada achieves maximum return on its R&D investment and facilitates the implementation and commercialization of CANMET-sponsored technologies by industry to generate wealth, create jobs and improve the quality of life for Canadians.

Management states that CANMET's shift to managing for results meant that the organization was ready for the changes imposed by the federal government's Program Review in 1993-94. Officials interviewed indicated that there was fear that the impending Program Review would cut CANMET's budget if the results and benefits of the program were not measured, made visible and demonstrated.

Many incentives support the move toward managing for results. Performance information is included in the accountability accords between the ADM, director general, and directors. These accountability accords are used for appraising the performance of managers by comparing their actual achievements with mutually agreed-on performance expectations.

A number of other departmental initiatives have continued to provide a supportive environment for managing for results. The managerial practices of NRCan have undergone substantial changes during the last few years. The adoption of a business planning process and Total Quality Management have prompted management to take more interest in the business value of investment in science and in meeting the business objectives of industrial clients. Efforts to increase client satisfaction with CANMET's services encourage staff to manage research and development projects to meet the specific commercial needs of industrial clients. NRCan is also developing and piloting a Science and Technology Management Framework, which is focussed on performance.

Recent federal government initiatives to renew the Expenditure Management System have also helped CANMET managers to maintain their focus on managing for results.

CANMET's environmental scanning demonstrates a capacity to learn and adapt. Business Plans include the results of business environmental scanning to identify emerging changes in related technology, business conditions, economy, government regulations, and managerial conditions. The Business Plans of the Energy Technology Branch and the Mineral Technology Branch include information on external and internal factors that are likely to impact on the operations of CANMET. Relevant issues and developments, and the branches' responses to the emerging changes and challenges are explained.

In terms of lessons learned in moving toward managing for results, departmental officials indicated that a results management culture and understanding must be developed before the practical tools can be implemented. Officials have indicated also that CANMET's next step in the move toward managing for results entails continuing the search for even more meaningful indicators that can be used as feedback in the decision-making process.

CASE 6: CREATING A CORPORATE CLIMATE FOR MANAGING FOR RESULTS AT ENVIRONMENT CANADA

Environment Canada, with about 4,600 employees and expenditures of approximately \$546 million, is a science-based department with a mandate to preserve and enhance the natural environment, and its renewable resources (including migratory birds and other non-domestic flora and fauna); conserve and protect our water resources; carry out meteorology; enforce the rules of the Canadian-U.S. International Joint Commission; and co-ordinate federal environmental policies and programs.

Senior management was instrumental in creating a corporate accountability framework. Faced with shrinking resources and the need to simplify the reporting of its programs, the deputy minister (DM) in 1991-92 started an initiative to integrate program results for the Department through a corporate accountability framework. Successive DMs continued this work, and their leadership and commitment encouraged the assistant deputy ministers (ADMs), regional directors general, and other executives to adopt managing for results and accountability practices. The Parliamentary Standing Committee on the Environment and Sustainable Development also played a role. In discussing the Department's performance report in November 1996, the Committee asked that the Department be able to demonstrate the progress it is making.

Exhibit 11.7 depicts the corporate accountability framework in which Environment Canada sets out how performance is to be measured in its three business lines: securing a healthy environment, ensuring safety from environmental hazards, and building a greener society.

Exhibit 11.7

(This exhibit is not available, see the Report)

The Department's budget is apportioned through four activities - three externally focussed business goals or lines, which are in turn divided into 10 components - and a fourth internally focussed activity called "Corporate Administration".

Discussion forums communicate commitment across the Department. Each component has its own forum, or “table”, of managers from across the Department to facilitate intra-departmental co-operation of the groups that are making a contribution to each component’s goal. The tables are co-led by an ADM and a regional director general. The component system of planning and reporting allows for managing toward results that requires co-operation across the organization. Although the Department believes this approach to be effective in developing consensus on its program direction and commitments, it continues to explore ways to simplify this approach and to link planning to expenditure management — while preserving the focus on integrated results delivery.

Every year, each of the 11 tables of Environment Canada managers, with their clients and partners, prepares an action plan identifying clear results statements, major deliverables and performance indicators. These action plans then serve as the basis for developing departmental documents such as the Corporate Business Plan, the Minister’s Action Plan, the departmental Performance Report, and the Report on Plans and Priorities.

The Department’s vision, mission and results are publicized. Environment Canada’s senior management shows continuing commitment by emphasizing results in published planning documents and using results to assess management performance. The Department’s overall vision and mission, as well as those of its business lines, are clearly articulated in the departmental documents.

Learning and adaptation is fostered. To foster learning and adaptation, the results of Environment Canada’s evaluations and reviews are being integrated into the process of corporate planning, performance measurement and accountability. The emphasis of reviews includes performance monitoring and reporting, implementing service standards, organizational learning and responsiveness, the achievement of results and accountability mechanisms or frameworks. This revised functional responsibility helps to build a results-based management culture in the Department.

Lessons learned. Environment Canada’s performance requires making, maintaining and enriching partnerships with other jurisdictions in Canada and other countries and with other sectors. Achievement of its goals are predicated on mobilizing others to act. In developing indicators in this context, the Department has learned that indicators are needed that:

- measure a range of results, from short to long term;
- pertain to the results of more than a single activity;
- reflect the cumulative impact of several partners; and
- measure system-wide results rather than focus on a single aspect of the ecosystem.

The accountability framework provides several benefits. Department representatives indicated that the accountability framework provides significant benefits. First, it facilitates *speed* — it is an effective mechanism to bring parts of the Department together quickly and mobilize knowledge. Second, Environment Canada could begin to answer horizontal questions, efficiently drawing information from across the Department. Third, the Department considers the framework a significant step toward resourcing trade-off decisions, but recognizes that there is a long way to go yet. Finally, the framework is important for maintaining focus on priorities and the long-term view (typically 25 years) for effort in the environment area to achieve results.

11.51 As well, experience has shown that any disincentives, inhibitors or constraints that discourage managing for results need to be dealt with if lasting progress is to be made. The starting point for a shift to managing for results in the U.S. Coast Guard was a 1992 assessment that showed that the attainment of desired outcomes — saving lives — was frustrated by overly centralized management that emphasized outputs, such as the number of vessels inspected and certified.

11.52 Innovation will be needed to implement managing for results. This implies a certain amount of trial and error. It is important that the response to mistakes incurred while innovating is measured and balanced and does not serve as a disincentive to further needed innovation. It is necessary to learn from errors and to move on.

11.53 Expertise in measurement concepts and practices. Management and staff may not immediately understand how measurement is best implemented, and may not fully understand, without advice, the implications that results-based measures have for managing operations. Unless managers and staff become comfortable with measurement, resistance to managing for results is likely. Management of the Employment Insurance program’s Investigation and Control function found, for example, that savings indicators were not implemented as rapidly as they could have been because managers initially did not see the measure’s implications for deciding which cases to investigate.

11.54 Consequently, managing for results requires training and communication on key concepts, as well as the exchange and sharing of experience, knowledge and best practices. In a report on progress in implementing the U.S. *Government Performance and Results Act*, the U.S. General Accounting Office stated: “To make the most of results-oriented management, staff at all levels of the organization must be skilled in strategic planning, performance measurement and the use of performance information in decision making. Training has proven to be an important tool for agencies that want to change their cultures.”

11.55 Adaptive capacity. Maintaining the capacity to achieve program results requires a learning organization, one that stays relevant and responsive to the changing needs of clients and the general public. Managers need the capacity to prepare themselves to cope with emerging challenges. The proactive monitoring of the business environment for emerging challenges and their potential impact on programs and program management is part of this capacity. Determining the effective responses involves systematically reviewing past experiences, learning lessons from past mistakes, and taking action to avoid repeating the same mistakes. The North American Waterfowl Management Plan, for example, operates on a 15-year planning horizon and is updated every five years. Evaluations test the assumptions of the Plan and provide information on the effectiveness of specific approaches.

11.56 The changing nature of government programs constitutes a significant barrier to implementing and maintaining a focus on results. Because of this, implementing practices for managing for results is never really finished. Restructuring in Natural Resources Canada led to CANMET being split into two separate branches in 1995, at which time its functions were joined with related policy functions. Due to the splitting of CANMET, and to other reorganizations, the business plans had to be restructured and only recently reflect CANMET’s orientation toward managing for results as clearly as they previously did.

Agreeing on expected results is key

11.57 Without agreement on what a program should be trying to accomplish, it is difficult for managers and staff to focus their activities and to agree on the success of these activities. There needs to be agreement on:

- objectives, especially outcomes;
- performance indicators; and
- specific performance expectations.

11.58 To avoid confusion, there also needs to be agreement on the terminology used. For example, Environment Canada has arrived at definitions of “outputs”, “intermediate outcomes” and “long-term outcomes”, linking these concepts to the kind of information required regarding the results of its activities.

11.59 As illustrated in Exhibit 11.8, CANMET has established internal agreement on expected outcomes through management retreats, discussions with management and staff and the use of accountability accords between executives and managers. Committees of directors general provide a forum for sharing experiences and practices and the exchange of information. Agreement outside the Department is fostered through the use of advisory committees involving external stakeholders.

Exhibit 11.8

CANMET: Reaching Agreement from the Bottom up on Expected Results

Mission, objectives and indicators focus on outcomes. CANMET’s Annual Report for 1995 and its Corporate Business Plan for 1994-97 (before the recent reorganization of CANMET) state that CANMET’s mission is to perform and sponsor predominantly commercial and cost-shared R&D and technology transfer (minerals, metals, and energy), in partnership with industry and other clients. CANMET’s mandate is: to enhance the competitiveness of Canada’s minerals, metals, and energy industries; to improve and develop energy

efficiency and alternative energy technologies; to improve health, safety and environmental control in the client industries; and to support government policy initiatives. In fulfilling its mandate, “CANMET is uniquely positioned to play a lead role in helping its client industries to generate wealth for Canada, create new jobs, protect existing jobs from foreign competition, increase exports and reduce dependence on imports.”

The above-noted descriptions taken together clearly convey what final outcomes or end results are to be achieved through CANMET’s R&D projects and subsequent transfer of innovative technology to its industrial partners.

A set of key performance indicators measures the effectiveness of CANMET’s interaction with its clients in leveraging funds, attracting financial contribution from industry, and promoting staff secondments. The indicators include full-time equivalents on staff secondment and interchange, value of task-shared and cost-shared work, revenue generation, and cost-effectiveness and cost-benefit ratios.

Consultative process ensures agreement from the bottom up on indicators and expectations. CANMET has taken a consultative approach to building indicators and expectations from the bottom up. Management retreats are used to develop business plans. Officials interviewed stated that these proposals are further discussed by middle-level managers and staff. As well, accountability accords between executives and managers include some of the same mutually agreed-on indicators, which are tied to the business plans. Such a consultative process helps to build consensus on key performance indicators, principles and values, direction and business planning among the different levels of management.

As well, officials stated that departmental committees of directors general provide a forum for sharing experiences and practices and exchanging information. This information is transmitted to the Department’s management committee in order to support the management of science and technology in the Department. This is one way in which information is fed to departmental management.

Industry committees provide advice on expectations and indicators. With the move to a more businesslike approach, CANMET devised key performance indicators. Several committees have a role to play in advising CANMET management on the targets, the performance and the methods used. Representatives are chosen primarily from industry (CANMET’s principal source of clients). As part of the advisory process, representatives provide advice and recommendations to the Minister on the overall performance of CANMET and also on specific issues, such as the need to revise or adjust targets.

11.60 Program objectives are the first step. Our cases provided good examples of clear statements of the results to be accomplished. Program objectives were stated as short-term, intermediate or ultimate outcomes or results to be accomplished, rather than as activities to be carried out.

11.61 Managing outputs is a necessary part of ensuring the efficiency and effectiveness of a program. However, outcomes represent the true value resulting from the investment of tax dollars. Therefore, managing outcomes, as well as outputs and activities, provides greater assurance that the intended value, reflected in the organization’s mission and overall objectives, will be achieved. To accomplish this, there needs to be agreement on what outcomes are implied by the mission and objectives.

11.62 Appropriate performance indicators are agreed to. Results can be measured in many ways, using many different kinds of information. A performance indicator is the measure actually used to assess a specific aspect of performance. No single indicator is adequate, and choosing the best set of performance indicators is central to ensuring that the right results are being measured. Without agreement on a balanced set of appropriate indicators, there is a risk that inappropriate performance will be encouraged. A balanced set of indicators will typically include indicators of both outputs and outcomes that reflect the key aspects of program performance.

11.63 For example, in developing a measure of the success of its efforts to detect and deter fraud and abuse, Investigation and Control management noted risks to focussing on “direct savings”— the total value of overpayments established and related penalties imposed. Inappropriate behaviours could be encouraged, such as allowing cases to “age” so that a larger amount could be recovered. Also, a focus on direct savings could have detracted attention from preventing fraudulent claims. To address these concerns, management added “indirect savings” — an estimation of the amount of inappropriate payments prevented through early intervention in a case. Investigation and Control also tracks a small number of secondary indicators, such as return on investment (the ratio of the total savings generated to the total I&C operating costs) to help ensure that its efforts remain cost-effective.

11.64 Agreement on clear and concrete performance expectations. Performance expectations describe the desired level of performance. Without agreement on clear and concrete performance expectations, it is difficult to know what level of performance is expected and to assess the extent to which expectations have been met.

11.65 Expectations are often expressed as targets. To be meaningful and to motivate staff to perform better, performance targets are frequently set to be challenging, but attainable. The North American Waterfowl Management Plan set targets for waterfowl populations and habitat conservation based on the partners' collective perceptions that population levels of the early 1970s were healthy and met public needs.

11.66 The targets can provide the basis for a performance contract between subordinates and their supervisor. The use of an appropriate participatory or consultative process in developing and implementing systems to measure program performance helps managers and staff to reach agreement on the system components, and to secure their commitment to use them. Such a consultative process helps to draw on the variety of skills and experiences of managers and staff and to develop sound and balanced results expectations. Customs Border Services of Revenue Canada, of which the Travellers Program is part, undertakes a joint planning process with its regions, producing accountability contracts between the assistant deputy minister (ADM), regional ADMs and regional directors. The accountability contracts specify expected performance and are the subject of discussion and input from field staff.

Performance Is Measured to Improve Results

11.67 Managing for results means accepting responsibility for results, improving them where feasible, and demonstrating accountability by reporting them. Improving results requires:

- measuring and reporting performance;
- using performance information to refine, focus and improve activities; and
- reviewing and updating indicators and measures.

Because performance and the environment influencing it are not static, review and updating of indicators and measures are also required.

Results are measured and reported

11.68 Measurement is the foundation on which results management is built. Without knowing the level of results being achieved, it is not possible to determine whether the results are adequate, how much more needs to be achieved to reach the desired level, and what efforts are needed to get there. Managing for results entails practices for collecting, assessing and internally reporting credible information on results and related program costs.

11.69 Exhibit 11.9 illustrates that the Travellers Program uses ongoing measurement and periodic studies to assess changes in performance and progress toward outcomes. It also shows that the information is reported to all levels inside the organization for use in decision making and management, and is also reported to outside users.

Exhibit 11.9

Measurement of Traveller Compliance Is Used to Improve Results

Ongoing measurement and periodic studies assess changes in performance and progress toward outcome targets. Compliance and responsiveness studies ("stint" studies) are carried out two or three times per year at each major port to test levels of traveller compliance and satisfaction. These studies are intended to yield statistically reliable results. They are conducted by examining travellers

at random after they have been screened by Customs inspectors at the primary inspection line. The results are then rolled up by major ports, regionally and nationally.

Current and projected performance results are assessed against actual levels of accomplishment reported in previous years. For example, the estimated 98 percent compliance rate for travellers entering Canada at highway points of entry in 1997-98 represents an increased target compared to the 1992-93 baseline of 94.9 percent.

Regular reporting provides timely information on progress toward outcome targets. The performance information is reported to the assistant deputy minister (ADM), Customs, the respective regional ADM and the director, Customs Border Services, as well as the border office examined. The performance information is used to determine whether progress toward the objectives agreed to in accountability contracts is on track at mid-year, and met by year-end. Improved program performance is facilitated by sharing and comparing the results in other areas of the country, maintaining dialogue and attempting to duplicate successful approaches. Customs Border Services published its achievements in the Revenue Canada Performance Report for the period ending 31 March 1996, and its results expectations in the 1997-98 Estimates — Report on Plans and Priorities.

Information is used to improve operations. The results of stint studies are used to adjust operations at the ports. For example, if non-compliance is high, the port's Customs inspectors would increase the number of travellers referred to secondary inspections or step up other enforcement activity, such as using "flexible response teams" to examine certain groups of travellers.

Information on compliance is used to focus enforcement activities. Using stint study information on potentially high-risk categories of travellers (i.e. places travelled, duration of travel, season of travel, and exemption claimed), Customs staff can optimize the effectiveness of their enforcement activities by targeting those high-risk categories.

Outcome and operational information is used to predict staffing requirements. Operational data such as volume of travellers, expected compliance rate, examination rate, and appropriate time standards for inspections are used by headquarters in a computerized modelling system to calculate required staff resources. The staffing information is then used to determine the number of staff needed to process the expected volume of traffic and meet the performance targets and standards.

11.70 A reluctance to measure and report outcomes has at times been a barrier to measuring and reporting results. Managers may be reluctant to measure and report outcomes, because these are often influenced by factors outside the control of the program and are therefore not under the control of management to the same extent as are outputs. Management will have direct control over such outputs as the number of inspections conducted, and the number of reports produced, but considerably less control over the impact these have on the behaviour of program clients and the resulting consequences for Canadians in general. The potential clients of the information may question the extent to which reported results can be attributed to program activities, which can contribute to management's reluctance to measure and report outcomes. Yet it is outcomes that are the most important indicator of the value received from public funds.

11.71 One lesson that has been learned is that a number of approaches to measurement may be needed. Outcome indicators will generally tell only how well the specific characteristic being measured is doing, not necessarily what the program's contribution has been. For this reason and other reasons, a number of approaches will be necessary.

11.72 Results can be measured in several ways — through ongoing measurement systems, periodic evaluation studies, occasional reviews, ad hoc cost/benefit analyses, client surveys, benchmarking comparisons, or long-term longitudinal studies — as appropriate to the nature of the program and the type of indicators used to measure performance. A combination of approaches is often necessary. Both quantitative and qualitative measures have a role.

11.73 Managers need to know more than simply the results. Measurement, perhaps through evaluations, should help managers to understand the extent to which the activities of their programs actually contribute to desired objectives, in relation to the role played by other factors.

11.74 In some instances, the required information may already be available. In other instances, additional or new information collection practices will have to be implemented. At the time of implementing the NAWMP, waterfowl

populations were already being monitored on an annual basis. However, measurement of the area of habitat protected had to be implemented to monitor progress toward meeting targets for this important result.

11.75 Another lesson that has been learned is that it is important to limit measurement and reporting to a restricted number of indicators. Indicators or measures of performance are most useful when they reflect the key dimensions of program performance. Since outcome, impact or effectiveness indicators are relatively less common than other types of performance indicators in government departments, and because of their crucial importance to managing for results, we have focussed on such types of indicators in this study.

11.76 The number of indicators chosen should be manageable, relevant and appropriate to the needs of the users of such information. Managers in the Investigation and Control function and the Travellers Program found that having too many indicators was a barrier to their use. Managing for results took hold when fewer key indicators were used.

11.77 Credibility is important. Reliable procedures for collecting data and assessing results against expectations are essential for providing credible and understandable information to program managers. This may involve specific assessments of the reliability of information. Reliability stems from how the indicators are measured and from the quality of the information used. Assuring credible information may require formal assessment of measurement procedures and data. In discussions between the Treasury Board Secretariat and Human Resources Development Canada for additional resources to obtain additional savings through Investigation and Control activities, the credibility of estimates of direct and indirect savings was paramount. Credibility was aided by conducting an evaluation of these indicators, independent of program management.

Performance information is used to improve performance

11.78 Measuring results is not sufficient. Managing for results means that performance information is integrated into the decision-making process and used. Exhibit 11.9 shows how the results of ongoing measurement and periodic studies in the Travellers Program are used to adjust activities, focus enforcement activities and predict staffing requirements.

11.79 Improved performance requires that, in addition to being reported and used externally, information be used internally to improve related management practices and program activities, as well as to support decision making. In our cases, we found a number of instances where results information was used to improve departmental practices, including the following:

- **Improve planning.** In 1994, the NAWMP was reviewed and updated based on results achieved, weaknesses and challenges. The updated plan implemented several recommendations regarding bird populations, habitat and supporting policies. Evaluation of the results of specific Joint Ventures is used to select the most effective habitat conservation methods. In the Prairie Habitat Joint Venture, a computerized planning model uses performance data to forecast costs and results.
- **Focus activities better.** Investigation and Control uses performance information to focus activities on areas likely to yield the greatest savings.
- **Assess policies, practices and regulations.** Investigation and Control has recently set up a unit in order to use performance information for assessing the implications of proposed changes to policies and practices. Environment Canada uses waterfowl population counts to review and modify hunting regulations.
- **Assist in resource allocation or reallocation.** Customs Border Services uses information on traveller compliance as one of the inputs to a computer model used to calculate staff required for border offices to meet performance targets and service standards. The Department has used traveller compliance levels and service quality

indicators, along with other performance information, to support requests for and obtain additional resources. Environment Canada is working to link its results information to expenditure management, to aid in making difficult program choices.

- **Demonstrate accountability between levels of management and assist in performance appraisal.** In CANMET, Performance Feedback Reports compare achievements against performance expectations included in accountability accords. These are discussed by supervisors with their subordinates during mid-year and year-end reviews and annual performance appraisals.
- **Monitor for problems and correct them.** Customs Border Services uses information on traveller non-compliance to identify border offices where increased inspection and enforcement are necessary.

11.80 In Chapter 5, Reporting Performance in the Expenditure Management System, we observed that communicating the use of results was an incentive for performance reporting. The visible use of results can also serve as an incentive to manage for results. For the North American Waterfowl Management Plan, making the use visible included making the results visible. The NAWMP published its performance information in its 10th Anniversary Report, *Taking Flight*, Joint Venture reports, such as the Prairie Habitat Joint Venture report, *Conserving an International Resource*, and other documents. These vehicles serve to communicate the goals and results achieved and to educate the public on the benefits of the conservation of wetlands and waterfowl. The Plan's high public visibility and international partnership arrangements contribute to making the value of the program well understood, thus helping to protect its resources. This has acted as an incentive for participating government officials to manage for results.

Indicators and measures are reviewed and updated

11.81 Because of the changing environment in which government programs operate, the implementation of managing for results is never complete. Experience suggests that all performance measurement and reporting systems can be improved.

11.82 Improvements may be needed to keep pace with a changing environment and with needs of the public. New program policy and features, and changes to priorities, budget levels, program delivery mechanisms, or organizational structure can quickly outdate a performance information system, affecting its credibility among users. Consequently, the relevant components of a performance information system must be modified to make the system relevant to prevailing circumstances, and to maintain its validity and credibility.

11.83 Based on experience gained within a program, changing circumstances, and experience gained in similar programs elsewhere, the performance indicators, expectations, and measurement and communication strategies used will need periodic review and improvement. The best strategy is to begin with a reasonable set of indicators and measures, and to continue to refine and develop them with experience.

11.84 Improvements may also be needed to adapt to changing levels of performance. With experience over time, an organization learns to perform better. Under these circumstances, performance targets used previously may no longer be challenging or realistic. Consequently, performance expectations need to be revised periodically to better reflect an organization's current operational capacity.

11.85 Review of the NAWMP reflects the need to adapt both to changing needs and changing levels of performance. The Plan, originally conceived of as a "duck plan", appears to have been successful in increasing waterfowl populations. Based on its success and current conditions, the 1994 review resulted in revision of waterfowl population goals. The Plan has also been expanded to include multi-species and biodiversity objectives to support the broader goals of biodiversity conservation, sustainable development and integrated resource

management. In particular, management believes that the Plan's reflection of broader benefits and values of wetlands and associated habitats will help to maintain and broaden the Plan partnership.

Conclusion

11.86 Many countries throughout the world recognize the need for managers to focus on obtaining desired results — both to meet concerns of citizens about the effectiveness of government programs and to ensure that good value is obtained for the increasingly stretched tax dollar. We found enough experience in Canadian and other jurisdictions to set out a framework for managing for results, to confirm the application of the framework to federal government programs in Canada and to identify some related good practices.

11.87 Managing for results benefits Canadians by contributing to better program performance. It also benefits public service managers by adding credibility to their efforts and assisting them in many of their management responsibilities, such as planning, decision making, responding in a timely fashion to queries, focussing activities and identifying and finding solutions to problems. And finally, it benefits ministers by focussing programs on the benefits they want to achieve for Canadians.

11.88 Past experience shows that shifting the focus from managing inputs to managing for results is not easy, but it can be done. The change takes time, usually about four to five years. Key to managing for results is persistence and the creation of a receptive climate, both across government and within individual programs and organizations.

11.89 Creating the climate presents challenges. Barriers are created by existing incentive systems that reinforce the management of inputs and activities, and by conflicting goals and public sensitivities. Key among these barriers is the desire to avoid risks. Overcoming these barriers requires strong leadership that can recognize the opportunity created by significant events in the organization or its environment and by communities of common interests in external partnerships. In organizations that manage for results, this leadership is shown by senior managers who overcome barriers by recognizing and communicating the value of information on results, consulting and seeking agreement on expected results and their measurement, providing supporting incentives, ensuring that the required expertise is developed and ensuring that risks are dealt with rather than avoided entirely.

11.90 Such change does not come without costs. Nonetheless, many of those who are managing for results see the costs of doing so as “part of doing business”, entailing no additional costs beyond that of the management practices replaced.

11.91 However, where the necessary supporting systems are not in place, costs will be incurred by their implementation. Careful consideration needs to be given to ensuring that the costs of the measures chosen are reasonable in relation to their benefits. The cost of not managing for results is less efficient and less effective programs.

11.92 Experience with managing for results is not yet widespread in the federal government. Ensuring continued progress will require ongoing attention and leadership across government, as reflected in efforts to improve reporting to Parliament and to encourage the sharing of experiences among government departments. It will also require internal and external decision makers to show that results count in good management by asking for information about results and by visibly using it as a basis for their decisions.

11.93 As leadership changes and as programs and their environments change, progress that has been accomplished can come undone. For this reason, an organization that manages for results is a learning organization — one that continually monitors its environment and learns from its experiences and past performance.

Treasury Board Secretariat's response: *We are pleased that the Auditor General has undertaken a study on managing and accounting for results in the federal government. We agree that establishing a climate within government that balances incentives for results and good management practices is important and that it will take some time to become fully realized. Essential steps are to define, measure and report on results.*

The government initiatives to strengthen the management focus on results include: changes in the Expenditure Management System; improved reporting to Parliament; the development of government performance indicators; and modernizing comptrollership.

We look forward to working with the Auditor General to identify good practices and to communicate them to departments, Parliament and Canadians.

About the Study

Objectives

Our objectives were:

- to propose and explain a management framework for encouraging greater progress toward managing for results;
- to identify lessons learned and best practices in moving toward managing for results; and
- to determine incentives and disincentives faced by departments and program managers in adopting a results-based management culture.

Scope

The study looked at progress in moving toward managing for results. We reviewed management practices that create an organizational culture that fosters managing for results, agreeing on expected results, measuring results, using information on results to improve performance and effectively reporting results. We concentrated on cases in several jurisdictions where results-based management practices are in use, or where initiatives are well under way to move toward managing for results. We reviewed their experiences and lessons learned regarding incentives, facilitators or enablers, and disincentives, inhibitors or constraints.

We looked at experiences in five Canadian federal government programs: The North American Waterfowl Management Plan jointly administered by Environment Canada, the Canadian Centre for Mineral and Energy Technology at Natural Resources Canada, the Travellers Program at Revenue Canada, Environment Canada's Department-wide accountability framework and the Investigations and Control Function of the Employment Insurance Program at Human Resources Development Canada.

We also reviewed progress in other jurisdictions, including U.S. federal government agencies complying with the *Government Performance and Results Act* of 1993 on a pilot basis, and progress in provincial or state governments, notably Alberta and a number of U.S. states, and in some local governments.

As this was not an audit, we did not verify the reliability of results information reported by any of the programs or organizations chosen as examples for this study.

Criteria

Because this was a study, we did not compare practices against a predetermined set of criteria. Rather, in conducting the study, we identified a set of principles that constitute a framework for managing for results, and assessed their applicability to the Canadian context.

Approach

We reviewed the relevant literature on the experiences in other jurisdictions, conducted on-site interviews with officials in Alberta; Portland, Oregon; Sunnyvale, California; and Texas, and reviewed related documentation. We conducted interviews with managers in four Canadian federal departments and reviewed related publications and documents. We also conducted interviews with the Treasury Board Secretariat on progress toward managing for results in these departments and on government-wide initiatives related to progress made.

In addition, we drew upon the evidence and findings from the April 1997 audit of Reporting Performance in the Expenditure Management System, conducted jointly with this study.

Study Team

Stan Divorski
Leslie Levita
Gerry Nera
Frances Smith
Shiv Sundaram
Mary-Louise Sutherland
Tom Wileman

For information, please contact John Mayne, the responsible auditor.

Chapter 12

Information Technology: Preparedness for Year 2000

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Information Technology: Preparedness for Year 2000

Assistant Auditor General: Doug Timmins

Responsible Auditor: Nancy Cheng

Main Points

12.1 The “Year 2000” crisis is a global phenomenon. It refers to the potential for systems errors, malfunction and failure as a result of the past practice by computer professionals and the information technology community of representing the year as a two-digit code. Year 2000 can threaten the functioning of government systems that support the delivery of programs and services to the public, as well as internal operations. The costs of dealing with Year 2000 issues have been estimated at as high as US \$600 billion globally. In Canada, total costs are estimated to range from \$30 billion to \$50 billion. The Treasury Board Secretariat has estimated the costs for the Canadian government at \$1 billion.

12.2 Year 2000 has been widely recognized as one of the largest information technology projects. The deadline is immovable and the next millennium is less than three years away. We concluded, as of the end of April 1997, that the rate of progress in mitigating the risks of systems errors and failure has generally been slow, and the residual risks are high. In addition, significant exposures such as competing priorities for systems development and insufficient technical resources could, if they materialize, jeopardize Year 2000 efforts.

12.3 The Treasury Board Secretariat has helped to raise awareness across government and facilitated the exchange of views and experiences on Year 2000 efforts. Its Year 2000 project office has been working with departments and agencies to identify and find solutions to common problems. The Secretariat advised us that its submission for funding government-wide initiatives was approved in late June for presentation to the Treasury Board during the summer of 1997.

12.4 However, if progress were to continue at the rate we observed at the time of the audit, it would likely be too slow to ensure that the government systems, including those that are critical to supporting major programs and essential services, will be ready in time. We are concerned that systems supporting government programs and services remain at risk. Failure of critical systems could affect public health and safety and essential services to the public. In our view, Year 2000 is a serious threat that requires urgent and aggressive action.

12.5 We have recommended that Year 2000 projects, including the development of contingency plans, be ranked among top priorities of departments and agencies. In addition, we have recommended that the Secretariat give high priority to its initiative on overseeing the successful implementation of the most critical systems for the government as a whole. We have also emphasized the need for sustained commitment and support from senior management and for continued engagement of ministers, as appropriate, to address exposures and roadblocks that can derail Year 2000 projects.

Introduction

The “Year 2000” crisis

12.6 During the past decades, Canadians have placed ever-increasing reliance on information technology in various aspects of our lives. Today, businesses depend on information systems for continuous operations but, more importantly, for competitive advantage and business survival. Similarly, governments rely on systems to deliver programs and services to the public and to support operations. The Year 2000 crisis threatens those systems on which we have come to rely.

12.7 Since the 1960s, it has been a common practice among programmers and computer professionals to represent a year by a two-digit code. Under this practice, the year 1997 would typically be represented as “97”. If left unchecked, upon reaching the year 2000 a system could interpret “00” to represent the year 1900. In addition, a system could revert to a “beginning-of-time” date, such as 1980 or the date on which the system was first implemented.

12.8 The date code, including the year, is used extensively in systems. In many applications, the date value is used in labelling, sorting, updating and other data manipulation functions. As a result, an incorrect interpretation of the date can play havoc with system outputs and results.

12.9 For example, Year 2000 could affect interest calculation on loans and mortgages. Other business applications, such as workload management, could also be affected. These applications often depend on proper sorting of casework by date. Cases beginning in 2000 could be listed as the least current if the year is interpreted to be 1900. Similarly, aging of accounts for credit and collection purposes could create reports that contain meaningless or inappropriate information.

12.10 Further, misinterpretation of dates could generate undefined outcomes, causing transactions to be rejected as errors, or processing to be aborted. It is also possible for the Year 2000 effect to be felt in advance; applications that generate expiry dates could fail well before 2000.

12.11 Overall, the consequences of the Year 2000 issue could range from something as innocuous as an incorrect date display on a screen or computer listing to a situation much more severe, such as processing being aborted or erroneous results that may not be readily detected by users.

12.12 Year 2000, also known as the millennium bug, century date change, Y2K (a registered trademark) and other variations, is not limited to large-scale, mainframe or older systems. All other systems could also be affected, including recent acquisitions and updates to systems as well as personal computers and work stations that are on the desks of most employees in many organizations. In fact, the threat extends to all micro-processors that support systems and embedded devices, beyond the traditional computer application systems.

12.13 The best-known examples are probably elevators and ventilation systems in facilities where system functionality may depend on micro-processors. Other, less obvious examples include bank vaults and components of an automobile that are controlled by computer chips. All of them can be vulnerable to the Year 2000 threat.

12.14 An independent research firm has estimated the costs worldwide to address the Year 2000 challenge at US \$300 billion to US \$600 billion. The estimates have been widely acknowledged within the computer industry and information technology community. The same firm has also predicted that some 90 percent of systems and codes will be affected by Year 2000.

12.15 This challenge comes with some unique characteristics. Most significant, the available time remaining to assess the situation and implement necessary changes is limited; there is no room for flexibility in deadlines or for extension of time. Moreover, Year 2000 transcends all industry and service sectors and has no geographical boundaries. The same project management and technical skills and resources will be needed everywhere at the same time. It is widely anticipated that the demand for these resources will exceed the supply as we get closer to 2000.

Possible effect on government services and operations

12.16 For the federal government, the stakes are high. If systems are not tested and made compliant where appropriate, Year 2000 could threaten the continuous delivery of programs and services. Systems that are critical in supporting major programs and essential services may fail as we approach the next millennium. The potential consequences for the government could be manifest as health and safety concerns, financial implications, disruption to essential services for the public or legal ramifications.

12.17 We prepared the following scenarios to illustrate the potential impact of Year 2000 on government programs and services. The scenarios are hypothetical and are possible only if the systems are not made compliant in time for Year 2000 purposes.

- Systems supporting search and rescue efforts may cease to function properly, which could cause undue delay in emergency situations.
- The Canadian Customs systems may not be able to support commercial cargo clearance and release processes at the border. The impact could be a choice between disruption to businesses and reduced or random inspection without systems support, possibly jeopardizing health and safety or assessment and collection of duties and taxes, which total billions of dollars annually.
- The system supporting the Employment Insurance program may not be able to generate proper payments, which could result in errors or delays in providing relief to beneficiaries of the program.
- The systems supporting the Receiver General functions may fail, which could lead to disruption or delay in paying vendors and suppliers for goods and services provided to the government.
- The system to enforce family orders and agreements may fail to trace and intercept federal payments to individuals who are in default of family support payments. Consequently, it could not redirect the payments to those who are owed the support, causing them financial hardship.

With appropriate and timely action, scenarios such as these can be avoided.

12.18 Many of the systems supporting government programs and applications are older systems that have used two-digit coding for the year. Moreover, these systems often operate in a decentralized environment with numerous interfaces inside departments, across government or with external partners. Decentralization and system interfaces add another complex dimension to overcoming the Year 2000 challenge. These factors, along with the sheer volume of existing systems in government, the time constraint and a limited supply of technical resources, expose government programs and operations to significant risk from the Year 2000 threat.

12.19 However, the federal government is not alone in its struggle. Businesses and organizations across Canada and other levels of government also face the Year 2000 threat. The information technology community has estimated that Year 2000 efforts will cost \$30 billion to \$50 billion in Canada.

12.20 In the business community, many large firms such as major banking institutions have been actively addressing Year 2000 issues, but many other businesses have yet to begin. In fact, one research firm has predicted widespread business failure as a result of Year 2000. The risks are particularly high for small- and medium-sized businesses, where the potential impact of Year 2000 may not be fully appreciated yet. Should a high rate of business failure occur, it could have a detrimental effect on the Canadian economy, with repercussions on the country's revenue, debt and deficit, and employment and social issues.

Focus of the audit

12.21 The audit examined the risks and exposures as of 30 April 1997 that government programs and operations face as a result of the Year 2000 threat. We reviewed the progress and state of preparedness in mitigating the risks at a number of departments, and initiatives undertaken by the Chief Information Officer Branch of the Treasury Board Secretariat to advance government efforts concerning Year 2000. In addition, we supplemented our audit with a general survey of departments and agencies.

12.22 The purpose of the audit was to provide information to Parliament regarding Year 2000 and to prompt appropriate action to address critical systems and those that concern the interests of the Crown and the public. The audit also sought to identify and highlight issues and areas that require further attention from Parliament and from management in departments and agencies.

12.23 Further information about the audit objective, scope and criteria are in **About the Audit**.

Observations and Recommendations

Senior Management Awareness and Support Visible since Early 1997

12.24 Further to discussions at meetings of the interdepartmental committee for heads of information technology, the Treasury Board Secretariat conducted a preliminary survey in late 1994 to assess the impact of the Year 2000 threat. However, many departments and agencies did not respond and, among those that did, the extent of analysis and information they provided varied widely.

12.25 In May 1996, the Treasury Board Secretariat established a project office within the Chief Information Officer Branch to provide leadership for the Year 2000 issue in government. The project office has been charged with the responsibility to oversee Year 2000 efforts within government and to address horizontal issues. The Year 2000 project office also initiated an interdepartmental working group to facilitate dialogue and to exchange views and experiences in dealing with the Year 2000 threat.

12.26 At that time, the Secretary wrote to heads of all departments and agencies, asking for information on their risk and exposure with respect to Year 2000, as well as their plans to address the issue. From the responses, the Secretariat's project office concluded that most organizations were not aware of the full scope and implications of Year 2000 for their operations. Many departments and agencies had only begun to study the full ramifications of Year 2000, and about 12 had concluded that the threat would have a significant impact on their operations, with potentially major costs to manage the risks. Further, according to the project office, the responses indicated that while senior management might have viewed Year 2000 as a potentially serious threat, preliminary assessments had since reassured many that the issue would be addressed through normal operations.

12.27 In the fall, the Secretariat assisted in raising the profile of the issue by making Year 2000 a standing item on the agenda of the interdepartmental committee for heads of information technology. The subject also appeared frequently as an agenda item for the information management committee, comprising deputy ministers as members.

However, by late 1996, many heads of information technology continued to express concern that senior management awareness and support were lagging.

12.28 In January 1997 the information technology industry, through the Information Technology Association of Canada and the Canadian Information Processing Society, wrote to all deputy ministers to express its growing concern about the millennium date change.

12.29 During the February 1997 meeting of deputy ministers, the Secretary of the Treasury Board presented the Year 2000 issue, providing a checklist and identifying a number of horizontal initiatives.

12.30 At Year 2000 conferences and symposia, it has been widely held that gaining senior management acknowledgment and support is not only essential but critical to the success of overcoming the Year 2000 challenge. While some information technology staff may have started to address the issue, awareness and support of senior management in most departments and agencies became evident only in early 1997. The ensuing challenge will be to sustain senior management interest and commitment over time.

Rate of Progress Has Generally Been Slow

12.31 Generic phases of a Year 2000 project. Organizations, computer professionals and consulting services have defined many models of the phases and stages in a Year 2000 project. Most have the same generic phases; some are categorized in more stages than others.

12.32 We categorized the phases as follows:

- project management structure;
- inventory, assessment and planning;
- conversion; and
- testing and implementation.

12.33 In general, the phases involve establishing a Year 2000 project office to manage the project for the organization. The project office mobilizes the project through fact finding, analysis and planning. The deliverables usually include a strategy and approach, an estimation of resources needed, an action plan with milestones and deadlines, and a contingency plan. The substantive work involves repairing, replacing or retiring existing applications and systems, followed by testing and then implementation. Exhibit 12.1 further describes the four phases.

Exhibit 12.1

(This exhibit is not available, see the Report)

12.34 While the phases tend to be carried out sequentially, there will be some overlaps. Project management, for example, spans the entire duration of the project.

Project management structures were generally in place

12.35 As described in **About the Audit**, we selected nine departments and examined the overall progress of their Year 2000 efforts. These departments deliver many of the government's major programs and essential services, such as those outlined in paragraphs 12.16 and 12.17. We also conducted a general survey of over 60 other

departments and agencies to gather information on the status of their Year 2000 work. We completed our substantive examinations in April 1997. The findings reflect our assessment of the status of the nine departments as of early May 1997.

12.36 We would expect departments to put in place a formal Year 2000 project management structure to secure senior management awareness and support, and to manage and contain the risks posed by the Year 2000 threat.

12.37 We found that all nine departments have established a Year 2000 project office. In most departments, the management structures are supported by an organization chart, and all but two have project charters that outline the terms of reference for the project and the relationships among stakeholders.

12.38 The project offices are led by full-time staff, primarily at the manager level. Senior sponsors for Year 2000 projects have been identified and most are at the level of assistant deputy minister.

12.39 We noted that, in seven cases, the senior sponsors are the heads of information systems and technology in their respective departments. The information systems and technology function needs to play a critical role in a Year 2000 project management structure. However, a complete alignment of a project office and its sponsorship with this function may perpetuate the belief that Year 2000 is solely an information technology problem. It has been widely held by the information technology industry that identifying Year 2000 as an information technology problem rather than a business management issue is a main obstacle in securing senior management awareness.

12.40 In one department, the information technology function issued a Year 2000 warning in June 1995 and requested that all branches submit a systems inventory; systems operation in that department is decentralized and is managed by individual program branches. Several submissions were received but were found to be inadequate. In July 1996, a working group was formed to raise awareness of the Year 2000 issue among branch management. In August, the head of information technology again requested an application inventory from the branches. In February 1997, the departmental management committee was briefed on Year 2000 and on progress in the department. The department formally established a project management office in April 1997. As of the end of April, the department had yet to complete its systems inventory and impact analysis with respect to Year 2000.

12.41 Further, there is a risk that the systems supported centrally by the information technology function could be emphasized over other systems that may also be essential in supporting programs and services delivered by the departments.

12.42 In general, we observed that the assessment and project plans for systems that support corporate services were more thorough and better documented than those for other systems. As an illustration, in one department we found that detailed plans were prepared for corporate systems. In contrast, there was limited information on applications and systems at the program branch level. As of the end of April, the identification and assessment of such applications and systems in that department had just begun. While the corporate systems are essential to support internal operations, many of the systems in the program areas are critical to sustaining program and service delivery.

12.43 We found the risk to be higher where the Year 2000 project management structure, including the senior sponsor, is part of the information technology function of the department and where systems operations are decentralized and controlled by program branches.

12.44 We noted that most departments we examined have used cross-functional committee structures to complement Year 2000 project offices. We found this practice to be an effective way to engage program branches, especially where more senior staff from these branches participate. However, as of the end of April, we had noted very few cases where Year 2000 project status and decisions had been brought to heads of departments for consideration.

12.45 We received about 50 responses to our general survey. About 70 percent of these responses indicated that a management structure for the Year 2000 project has been established. Of those organizations, about half showed that committee structures are being used, with regular briefings to senior sponsors.

12.46 In addition to managing one of the largest information technology projects, Year 2000 project teams in general face an important challenge in gaining and maintaining senior management support and commitment. In the absence of relentless efforts to engage departmental executives on an ongoing basis, the probability of success for Year 2000 projects will be greatly compromised.

Assessment of critical systems still in progress

12.47 An inventory of systems serves as the basis for establishing the nature and magnitude of a Year 2000 project. It is therefore essential that the inventory be complete and include all systems, from components and modules of application systems to infrastructure and platforms that support the systems and processors that control various devices and facilities.

12.48 We found that all nine departments had completed an inventory of their corporate systems. Seven departments were in the process of completing a departmental inventory for use in impact analysis. In two of the nine departments, however, computer-controlled devices and facilities were explicitly excluded from the Year 2000 project mandate.

12.49 During this phase, project offices are expected to analyze the potential impact of systems failure as a result of the Year 2000 threat. Based on the impact analysis, project offices are to assess and assign priorities and prepare a strategy and an action plan to address the problem.

12.50 Of the nine departments, we found that three had identified and granted priority to systems that are critical to their program delivery. Five departments were in the process of assessing the criticality of systems. In the remaining department, plans were at a general level and there were no documents identifying its critical systems.

12.51 Analyzing and ranking critical systems are important steps in a Year 2000 project. The prioritization allows efforts and resources to be devoted first and foremost to the critical systems. In the event that time or resources do not permit the conversion of all major systems, critical systems would be the first to be preserved.

12.52 The results from our general survey were generally consistent with those in the departments we audited. Only 37 percent of the departments and agencies that responded indicated that they had completed an inventory and assessment of their systems.

Most departments examined were at various stages of planning

12.53 We found that three departments had adopted a strategy for conversion. One department was in the process of piloting solutions. Another department has adopted an outsourcing strategy. Two other departments were completing general planning and scoping; one of those had started to conduct detailed analysis of application systems and available tools and solutions. The two remaining departments were developing plans to address Year 2000.

12.54 Some Year 2000 plans of the departments we examined were general; some contained more details and specificity in scoping the magnitude of the Year 2000 work. It is evident that those with detailed plans have more rigorous support for estimating efforts and resources needed for the Year 2000 project. We noted that some departments used executable lines of code in major applications as a basis for estimating the necessary effort. Two departments used the function point analysis technique to quantify the extent and complexity of conversion work

required. The more detailed information a project office has on the systems inventory, the less room there will be for surprises and cost escalation at a later stage.

12.55 We would expect plans to include timetables and milestones for Year 2000 work and an overall cost estimate. Time schedules and milestones establish a reference point against which a project office can monitor progress. Cost estimation is necessary to quantify the resources needed to address Year 2000. It also serves to determine whether the organization's internal resources are sufficient for the tasks or whether it needs to request incremental funding.

12.56 We found that detailed time schedules existed in five departments. A sixth department had time schedules for its pilots and activities in the near term but not at the project level. The detailed schedules and milestones are important tools for Year 2000 project managers. Slippage and changes can then be identified and corrective action taken to keep the project on course for completion before 2000.

12.57 Given that the departments were at various stages of planning, not all had completed cost estimates for the Year 2000 project. We noted that some departments used general estimates; others based their estimates on the number of lines of code or on other measures. One department prepared estimates only for the upcoming fiscal year or immediate pilots. Another department prepared costing on the basis of incremental funding. These are funds that are over and above the approved departmental budget and that are necessary to carry out the project.

12.58 As of the end of April, some plans had not identified the major systems interfaces with other departments and outside organizations. Systems interfaces represent a major exposure to the Year 2000 threat. An inability to anticipate date format and to exchange data can significantly curtail the functionality of systems.

12.59 Departments that have project charters and plans have indicated to us that these planning documents have been presented to senior management. However, with one exception, none have been formally endorsed or approved.

12.60 As noted earlier, securing and sustaining senior management support and commitment are essential for success. Seeking the endorsement of senior management for Year 2000 plans and engaging it early in recognizing potential resource requirements are ways to involve management from the start. This practice is particularly important in departments that are using a decentralized approach to managing the Year 2000 project. In a decentralized setting, individual branches and system owners may assess the criticality of their systems and develop and implement their plans independently of one another. In addition to playing a co-ordinating role, a project office needs to engage senior management to ensure that systems that are critical to the department as a whole are accorded the highest priority.

12.61 Our general survey of all departments and agencies showed a similar status. Two thirds of those that responded indicated that they have yet to complete the planning phase. The survey instrument requested a copy of the inventory, assessment and plan where these activities were complete. Of the 18 departments and agencies that indicated completion, only 4 forwarded a copy of the documents to us.

Few departments among those audited have started code conversion and modifications

12.62 Through the planning phase, departments may decide to repair, replace or retire their systems to counter the Year 2000 threat. Where it has been determined that an application will be converted through repair, the affected program codes will have to be identified and modified.

12.63 Two departments advised us that code identification and repair work have been taking place for a number of years as part of regular systems maintenance. One department in particular has been conducting the necessary repair work through its maintenance program for over five years.

12.64 However, of the nine examined, we are aware of only two departments that have started program code conversion and modifications as a result of Year 2000 plans. Only one of those two was able to demonstrate progress in conversion work and presented documents for our review. The remaining seven departments have yet to commence the conversion phase of their Year 2000 project.

12.65 The Year 2000 plans from most of these departments also call for the replacement of existing non-compliant systems. Some departments have been developing the replacement systems; others contemplate acquiring and implementing third-party products. Most of these systems are large-scale and complex in nature.

12.66 Based on experience with past audits of systems under development, we are concerned that some of these replacement systems may not be implemented in time to counter the Year 2000 threat. As noted in past audit reports, historically only 16 percent of systems were delivered on time and within budget.

12.67 We noted that three departments have identified specific deadlines and milestones for these development projects. Should the milestones not be met, “drop dead” dates have been established to begin repair work on existing non-compliant systems. These dates have been established as the earlier of:

- the latest milestone date that will allow the new system to be in place before 2000; or
- the last start date possible for repair work on existing systems for implementation by 2000.

12.68 In our opinion, where existing systems can be repaired, it is essential to establish contingency dates and to carefully monitor the progress of projects where critical systems are to be replaced, in order to manage risks associated with systems development.

Residual Risks for Departments and Agencies Remain High

Present rate of progress would likely be too slow

12.69 Our examination of the nine departments showed that, as of the end of April 1997, most of them had not progressed beyond planning to converting their systems. Our general survey of other departments and agencies showed a similar status. With two years and eight months remaining, the race against time is on.

12.70 The generic phases outlined in Exhibit 12.1 are necessary steps in every Year 2000 project. While there may be enough time to convert systems, sufficient and appropriate testing will likely be at risk.

12.71 In setting out the stages of Year 2000 projects, independent research firms have also estimated the proportionate levels of effort and of resources associated with each stage. Exhibit 12.2 sets out the estimated proportion of resource use for the generic phases, as proposed by two research firms.

Exhibit 12.2

(This exhibit is not available, see the Report)

12.72 The exhibit shows that the testing and implementation phase takes 54 to 60 percent of the total level of effort, exceeding the inventory, assessment and planning phase and the conversion phase combined. When we completed our audit, most departments and agencies were in the process of completing the inventory, assessment and planning phase, and only a few had started conversion. Consequently, the federal government could yet face undertaking 65 to 90 percent of the total effort needed to overcome the Year 2000 challenge.

12.73 The information technology industry recommends that organizations have all compliant systems implemented by the start of one full business cycle in advance of 2000. The purpose is to allow for time to correct any unanticipated problems before the production cycle enters the next millennium. This practice is being followed by many private sector companies that are actively countering the Year 2000 threat.

12.74 The fiscal cycle for the government begins in April. Thus, to allow for one full fiscal cycle to address unanticipated issues, departments and agencies would need to target implementation for 1 April 1998.

12.75 Two of the nine departments examined have set the target date for full implementation at 1 April 1998. Five organizations that responded to our general survey also indicated that full implementation will be in place by that date. Of those organizations that responded to our general survey, only 35 identified target implementation dates. Exhibit 12.3 shows the range of implementation dates identified by departments and agencies.

Exhibit 12.3

(This exhibit is not available, see the Report)

12.76 We are concerned that the rate of progress of Year 2000 work may not allow for sufficient testing of systems and that, after the systems are implemented, there may be limited opportunity to correct any unanticipated errors before the year 2000. In our view, the residual risks for departments and agencies remain high. With less than three years to go, we are concerned that if progress continues at the existing rate it will likely be too slow to counter the Year 2000 threat effectively.

Contingency plans need to be developed

12.77 The Year 2000 plans and schedules of the departments have not provided for slippage. Thus, delays or failures in meeting milestones could result in a further compression of the testing and implementation phase or in failure to implement systems prior to 2000.

12.78 At conferences and symposia on Year 2000, the concept of systems triage has been raised — that is, where it has been determined that not all systems can be salvaged in time, priority ought to be given to those that would benefit most from the remaining time and resources. In the Year 2000 context, top priority needs to be assigned to systems that are critical to an organization's business lines or program mandate.

12.79 In general, the departments examined have been planning to carry all systems into the next millennium and have deliberately not been contemplating triage. Given the amount of work involved in Year 2000 projects, the immovable deadline and the early stages of progress in general, systems triage may become necessary for some departments and agencies.

12.80 Indirectly, a form of systems triage has been applied in some larger departments. We noted that some departments applied less rigour in identifying for inclusion in their inventory small administrative and operational systems, such as those developed and maintained locally in regions, and end-user applications at the desktop. In those departments' view, the risk and thus the priority are lower for these systems and applications. The departments indicated that these systems and applications tend not to be critical to departmental programs and operations and, should they fail, could be replaced more readily and expeditiously.

12.81 At the conclusion of the inventory, assessment and planning phase, some departments and agencies may find that there is insufficient time to convert all systems. Slippage could occur during conversion and testing and could cause project offices to re-evaluate the viability of some systems upon entering the next millennium. These circumstances may force triage upon an organization. If triage were to be applied, it would be essential for a project office to engage senior management, including the head of the department or agency, to ensure that the decisions made would best serve the organization and its program recipients.

12.82 With or without triage, it would be prudent to plan for the possibility that some systems, upon reaching 2000, may not continue to function as designed. Therefore, we would expect departments and agencies to develop contingency plans.

12.83 As noted in paragraph 12.67, some departments have developed first-level contingency plans, by establishing “drop dead” dates to start repair work on existing systems should the development of their replacements fail to meet key milestones by those dates. Staff from some departments indicated that contingency planning has been under initial discussion. However, none of the nine departments have started preparing substantive contingency plans for their systems. In the general survey, three organizations indicated that they have prepared Year 2000 contingency plans. Although the plans were requested in the survey instrument, we received none.

12.84 Many organizations may have various forms of disaster recovery plans and backup systems in place. However, it is unlikely that these measures alone will be sufficient in the event that systems fail as a result of Year 2000.

12.85 In general terms, many such measures anticipate disaster striking and rendering systems not functional for a period of time, until they are replaced or put in order. In the meantime, processing could continue at an alternative site with backup systems and data files. However, it could take months or longer for some Year 2000 conversions and implementations to be completed, and there are no backup systems and files that could help to support programs and operations in the meantime.

12.86 The preparation of Year 2000 contingency plans can be time-consuming and onerous. Departments need to develop work-around arrangements and decide how they would be implemented. The arrangements may involve changes in staff deployment. Interim procedures and additional verification of output data may have to be developed. Staff training may be required to introduce these procedures and verification. Furthermore, there may be a need for a communication plan to inform staff, users of the program and services and other stakeholders to gain their acceptance of the changes and allow for a proper transition.

12.87 In our view, Year 2000 contingency plans need to be developed and ought to be completed with sufficient lead time for implementation, if needed, before 2000.

The Treasury Board Secretariat found that problems require more attention at many larger departments

12.88 The Year 2000 project office of the Treasury Board Secretariat undertook a survey of departments and agencies in early 1997. In March 1997, the survey instrument was sent under the Secretary’s signature to all departments and agencies, seeking the following information:

- status of Year 2000 activities;
- identification of critical systems;
- identification of external interfaces and system dependencies;
- incremental funding required for Year 2000 by fiscal year; and
- human resources requirements.

12.89 The survey instrument included detailed appendices to provide guidance to departments and agencies on elements to consider in costing Year 2000 efforts, and on factors to help determine the criticality of systems. The

survey was to be completed and returned to the Secretariat by 30 April 1997. In conjunction with the survey, the project office conducted interviews at about 80 departments and agencies, primarily during March and April 1997.

12.90 Through its survey responses and interviews, the Secretariat's project office assessed the state of Year 2000 work at 70 departments and agencies (Exhibit 12.4). The project office observed that, overall, 75 percent of these organizations had the situation under control or had adequate Year 2000 projects in place. The assessment further highlighted that 14 larger departments and agencies were in a state of "requiring more attention". The project office also noted that the most critical systems for the government are in the larger departments. The Secretariat advised us that its Year 2000 project office plans to focus its attention on these departments.

Exhibit 12.4

(This exhibit is not available, see the Report)

Significant exposures still ahead

12.91 During the audit, we noted a number of significant exposures to risks. They loom over the Year 2000 project and have the potential to derail an already tight time schedule for most departments and agencies. We identify five of them in the following paragraphs.

12.92 Competing priorities and developments. Information systems and technology functions at departments and agencies are often faced with demands for changes to existing systems and implementation of new systems through internal development or commercial off-the-shelf products. Such demands compete with Year 2000 projects for the same limited resources.

12.93 Some of the demands for change arise from existing program or operational needs; others may be driven by government-wide initiatives. Still others could be a result of legislative or other promulgated program changes. While some senior managers may be aware of the exposure to risks, senior management in all departments and agencies needs to be made fully aware and to commit to keeping other systems development work to a minimum.

12.94 Where other development work needed for government-wide initiatives or legislative and program changes threatens Year 2000 projects, senior management may have to request a delay in implementing the initiatives or seek legislative reprieve, if necessary.

12.95 Insufficient technical resources. The inability to secure sufficient technical resources to carry out a Year 2000 project is probably one of the most serious concerns to senior information technology officials. Departments and agencies can be affected in one of two ways.

12.96 Internally, they may face the risk of losing key technical staff to outside organizations. As opportunities increase for technical expertise to deal with Year 2000, compensation and remuneration in the private sector become more attractive to skilled individuals, making it increasingly difficult for departments and agencies to retain key technical staff.

12.97 There is also a risk that, as we approach 2000, private sector firms may not be able to continue to supply sufficient computer professionals to repair or replace systems, regardless of contract rates offered. Since Year 2000 is a global issue that affects and has the same deadline for all organizations, the demand for expertise is likely to exceed the supply as time passes. Some computer professionals have predicted that this will start no later than late 1997.

12.98 As we concluded our audit in early May, officials in some departments advised us that a higher than usual rate of turnover of computer staff has begun. The news media also reported that compensation for these professionals has started to rise.

12.99 On an ongoing basis, senior management needs to be kept apprised of how its department or agency is being affected. Departments and agencies may need to call upon the Treasury Board Secretariat to help address this risk.

12.100 Failure or delay in obtaining compliant upgrades from vendors. Third-party vendors supply numerous products to departments and agencies. They range from processors and devices to operating and application systems. Many of these products are not compliant for Year 2000 purposes, including, possibly, acquisitions made in recent years.

12.101 Many vendors have indicated that new versions and upgrades will be compliant and will be released at some future date. Some have yet to reply to queries from departments and agencies on the status of their products, or on whether and when some future upgrades will become compliant.

12.102 To control this risk, Year 2000 project offices need to leave sufficient time to acquire alternative compliant products should vendors fail to meet announced release dates. Depending on the implications of the specific exposure, it may need to be included in the contingency plan.

12.103 Data interface exposure. Many systems interface with one another to provide functionality to groups of users. Albeit that arrangements can be made in advance for the mode and format of data transfer, errors can occur and some partners could fail to make the changes in time.

12.104 The extent of dependency on other systems varies from system to system. In addition to internal interfaces, many systems in departments and agencies interface with those of other departments, other levels of government and external partners. The impact could range from rejecting a limited number of transactions that can nevertheless be rekeyed, to compromising the integrity of the recipient organization's data files.

12.105 Repairs of all necessary linkages have to be co-ordinated and made. For interfaces involving other government organizations and external partners, Year 2000 project offices need to be vigilant in confirming Year 2000 compliance prior to mutually agreed changeover dates and allowing sufficient time for testing. If a transfer of non-compliant data could be severely detrimental to departmental systems, the project offices may have to explore "what if" scenarios and include them in their contingency plans.

12.106 Risk of funding delay. As reported earlier, many departments and agencies have yet to complete cost estimates for the Year 2000 project. Without meaningful information on overall funding requirements, it would be difficult to ascertain what shortfall from existing systems maintenance budgets might arise and, in turn, for senior management to determine if it would need to request incremental funding beyond departmental budgets.

12.107 As we have noted, the costs for Year 2000 will be significant. As of early May 1997, the Treasury Board Secretariat estimated \$1 billion as the overall cost of making government systems compliant for Year 2000. It was anticipated that some departments may request significant incremental funding, potentially totalling hundreds of millions of dollars.

12.108 There is a risk that tasks and action on the Year 2000 project would be delayed if funding commitment were not to be secured on a timely basis.

12.109 With or without submissions to the Treasury Board for incremental funding, senior management may have to be prepared to fund Year 2000 projects internally to ensure that they do not sustain undue delay.

Aggressive Government-wide Action Is in Order

Need to rank Year 2000 among top priorities

12.110 The Secretariat has been actively raising awareness of Year 2000 across government. The interdepartmental working group set up and chaired by its project office has provided a forum for discussing views and exchanging experiences in Year 2000 work. Through its surveys, the working group, and other interdepartmental committees involving heads of information technology and deputy ministers, the Secretariat has played a meaningful role in co-ordinating and facilitating Year 2000 issues.

12.111 However, we observed as of April 1997 that the government's rate of progress against Year 2000 has generally been slow, and the majority of the total effort required has yet to be undertaken. We have also concluded that the Year 2000 risks facing departments and agencies remain high.

12.112 The amount of work still required is staggering, and the time remaining is limited. Computer professionals have often used an average number of systems or components that need to be converted, tested and implemented every week as a reminder of the magnitude of the task at hand in relation to time that remains.

12.113 The data we gathered from the audit and our general survey showed that the target implementation date of 1 April 1998 will not be attainable for most departments and agencies. Our discussion with private sector experts indicated that 1 January 1999, which allows one calendar year for delays and unanticipated problems before 2000, is emerging as the industry standard as the last day to fully implement Year 2000-compliant systems. At the end of our audit, only 20 months remained before that date. It is not uncommon for departments and agencies to have to address hundreds of modules, components and systems for Year 2000 purposes. Assuming an inventory of 100 potentially affected systems or components, an organization would have to analyze and test, and possibly convert and implement, an average of five systems or components per month, or at least one per week on a continuous basis, to meet the Year 2000 schedule.

12.114 Moreover, we observed that substantive contingency plans have not been developed and that exposure to many significant risks could derail Year 2000 projects.

12.115 We are concerned that many systems that are critical to supporting government programs and services are at risk. The rate of progress that we observed would likely be too slow to assure continuous systems support for the delivery of these programs and services. The government needs to rank Year 2000 as one of its top priorities and develop contingency plans. There is a need for urgent and aggressive government-wide action. Subsequent to the audit, the Treasury Board Secretariat advised us that, in its view, the government's rate of progress has been accelerating and aggressive action is under way.

12.116 As noted earlier, the ability of a departmental Year 2000 project office to elicit sustained commitment and support from senior management throughout all of the phases is critical to the success of the project. From our examination of the nine departments, we identified several matters that merit attention from senior management. Exhibit 12.5 provides a sample of these matters.

Exhibit 12.5

Sample of Matters Requiring Support and Commitment from Senior Management

Demand regular progress report on Year 2000, ask frequently. Most departmental management committees meet weekly. Senior management should demand progress reporting on at least a monthly basis, and more frequently if slippage occurs or when key milestones approach.

Seek assurance that all significant programs and operations are included and ranked appropriately. Senior management should seek assurance that all branch heads have satisfied themselves about the completeness of systems inventory for Year 2000 purposes. It should approve the prioritization and ensure that it is done in accordance with program significance and potential Year 2000 impact.

Involve internal audit and evaluation as a source of assurance. Many departments that we examined have involved internal audit and evaluation as part of their Year 2000 projects or as an independent process. Departments should use the internal audit and evaluation function as a source of assurance. This could involve ensuring the completeness of inventory, progress according to plan and schedule, completion of milestones, and fulfilling quality assurance functions.

Secure department-wide support in event of systems triage. Where systems triage becomes inevitable, senior management should ensure that there is corporate support for focussing on the chosen systems. Senior management should be satisfied that the decision would best serve the interests of the department and its program recipients.

Call for contingency plans. Senior management should ensure that contingency plans are developed. Where implementation of the plan is necessary, sufficient lead time should be allowed.

Monitor potential roadblocks and exposures and address them if they materialize. There can be many roadblocks and exposures that could jeopardize the Year 2000 project. Some could affect many departments; some could be specific to a department. Senior management should remain on guard and be prepared to address them, at the departmental level or working with other departments and central agencies, if they arise.

12.117 In particular, at those larger departments and agencies with critical systems and where the Secretariat has determined that the Year 2000 problem requires more attention, the Secretariat needs to ensure that senior management in each of those organizations is engaged on an ongoing basis in addressing the problem.

12.118 Departments and agencies should rank Year 2000 projects among their top priorities and develop contingency plans. Senior management should provide support to the Year 2000 effort on an ongoing basis and should address roadblocks and exposure to risks as they arise.

12.119 The Treasury Board Secretariat should assist departmental efforts by continuing to engage senior management of departments and agencies in sustaining commitment and support for Year 2000 projects.

Need for a government-wide perspective

12.120 The government delivers its programs and services to the public through many departments and agencies. The departments and agencies are at various stages in their Year 2000 projects and have different capacities to address the issue. Further, while individual departments and agencies are addressing systems that are critical to their own programs and operations, it is also important that specific attention be given to systems that are most critical to the government as a whole.

12.121 Collectively, the government needs to identify and assign priority to a manageable number of systems that are most critical to supporting major programs and essential services, and to charge a specific group to oversee their successful Year 2000 implementation. These are systems that can have significant consequences in such areas as health and safety, financial implications, public interest and hardship, and legal issues.

12.122 The Secretariat's Year 2000 project office has a mandate to oversee Year 2000 efforts across government. It advised us that its work plan includes an initiative to monitor the state of readiness for all mission-critical systems. It indicated that the initiative calls for updates of departmental progress in September 1997 and January 1998, but the means through which the information will be collected and analyzed have yet to be developed.

12.123 Departments and agencies would continue to be responsible for these systems as part of their Year 2000 projects. In our view, the oversight role would be primarily to ensure that the schedule and milestones are in place, and that they allow for sufficient testing of the applications and for time after implementation to correct any detected errors before 2000. The oversight role could also include ensuring that contingency plans would be

developed for these systems. On an ongoing basis, the Secretariat's project office would monitor progress for these systems and intervene strategically as appropriate.

12.124 Where systems in more than one organization interact to support a program, the Secretariat's project office would have the additional role of ensuring that all related systems and applications were identified and monitored. The functionality of these systems could be significantly curtailed if some component systems were not converted and implemented in time.

12.125 Subsequent to the audit, the Secretariat advised us that within its initiative of monitoring Year 2000 in government, it plans to focus its attention on the most critical systems. Its project office further indicated that an initial list of such systems has been prepared and is under review internally.

12.126 **The Treasury Board Secretariat should place high priority on its monitoring initiative, in particular, its effort in identifying and overseeing a manageable number of the government's most critical systems. It should intervene strategically as appropriate to ensure their successful implementation before 2000. This should include the development of related contingency plans to ensure continuous systems support for major programs and essential services into the next millennium.**

A role for ministers and Parliament

12.127 Given the potential significance of the issue, we would expect ministers to be engaged in the Year 2000 challenge and Parliament to be kept informed of the issue and its potential effects on government programs and service delivery.

12.128 In examining the departments, we were not able to confirm that any briefings had been given to ministers. At the Secretariat, its project office had been preparing a presentation since early 1997 to inform Treasury Board ministers of Year 2000 and to seek funding to manage a number of related government-wide initiatives.

12.129 In late June, the Secretariat advised us that a submission had been approved for presentation to the Treasury Board ministers during the summer of 1997. The Secretariat further indicated that a second submission would be made in the fall to advise Treasury Board of the state of the government's preparedness for Year 2000 and the estimated related costs.

12.130 In our view, ministers ought to be enlisted to support the Year 2000 initiative. Their support could be invaluable in overcoming roadblocks and exposures that may materialize later. Furthermore, Parliament ought to be kept informed of this impending threat and the government's progress in countering it.

12.131 **Departments and agencies should engage ministers on a timely basis, to advise them of the urgency of the Year 2000 threat to government programs and services and to gain their support in overcoming roadblocks and exposures that may arise. The Treasury Board Secretariat should continue to involve Treasury Board ministers and advise them periodically of the government's progress in managing Year 2000 projects and government-wide initiatives.**

12.132 **The government should keep Parliament informed of Year 2000, the potential impact on government programs and services and its progress in making systems compliant for Year 2000.**

Opportunities Exist to Gain Efficiency

12.133 The primary focus of Year 2000 projects is to control the risks of systems errors and failures that could disrupt or jeopardize government programs and services to the public. At the same time, opportunities exist to gain

efficiency in Year 2000 efforts across government. Acting on some of these opportunities can counter some of the exposure to risks we have identified; acting on others can help reduce duplication of effort among departments and agencies. We would expect that in countering the Year 2000 threat, initiatives would be undertaken to address common issues across government in order to maximize cost effectiveness.

12.134 Since the establishment of the Year 2000 project office at the Treasury Board Secretariat in 1996, efforts have been made to identify issues that can be managed horizontally to benefit all departments and agencies. Through establishing an interdepartmental committee, the group has been identifying horizontal issues and developing a work plan to address them.

12.135 The Secretariat intended to present the Year 2000 issue to Treasury Board ministers in March 1997 to seek endorsement and approval of funding for the work plan. As we completed our audit in early May, the Secretariat was in the process of revising its presentation and preparing the Year 2000 work plan. In late June, the Secretariat identified 12 government-wide initiatives and their related funding requirements and a list of 6 challenges. The initiatives and their funding requirements were subsequently approved for presentation to the Treasury Board.

12.136 We note in the following paragraphs some issues that, in our view, merit particular attention on a government-wide basis.

12.137 Shortage of technical resources. Retention of key staff is an area of exposure for many departments. The larger departments that conduct a significant portion of systems development in-house are particularly at risk. Private sector firms have started deploying special strategies to retain their own key technical staff for the duration of their Year 2000 projects. The nature of the issue calls for a government-wide initiative.

12.138 The Secretariat facilitated a working session with departmental representatives in May to discuss human resource issues and to identify options for retaining staff. It advised us that the Chief Information Officer Branch has also developed an action plan for managing human resources in the information technology community, and that the plan includes needs that relate directly to Year 2000 as part of La Relève, an initiative to address human resource issues in government.

12.139 General concern has also been expressed about the length of the procurement cycle. Full procurement cycles can take six to nine months to complete. The longer the cycle takes, the lower the possibility of engaging appropriate contractors and the higher the cost for their services. The Secretariat indicated that an interdepartmental group was being formed to review the procurement process and address this means of securing technical resources.

12.140 Vendor compliance. All departments and agencies require information on the state of compliance of existing versions of vendor products and the monitoring of development of future compliant releases. Efficiency can be gained by tasking a single group to communicate with vendors and monitor future development.

12.141 In 1996, a procurement group of one department started developing a repository of vendor product information. It has since been determined that more specific information will be required. At the time of our audit, that effort was being continued by another group, adding specific information on the products as they relate to various operating environments that the department supports. Resources needed to broaden the base to all departments and agencies and to share the information with them had been estimated and were awaiting approval.

12.142 Shared systems certification. A number of systems in administrative areas such as financial management and human resources have been identified as ones that will be shared across government. Since these systems will be implemented in more than one department, efficiency can be achieved by ensuring once, for all users, that the applications are compliant for Year 2000 purposes.

12.143 The Secretariat commissioned a review of these systems in early 1997 and reported that many of the applications were or would become compliant for Year 2000. The review also identified areas where the

infrastructure and work station environment require changes in order for the shared systems to remain functional in 2000.

12.144 The review was not intended to and did not include validation of the commercial applications. To serve departments and agencies and allow them to focus on their own information technology infrastructure and environment, there would be merit in seeking vendor or third-party certification for the applications.

12.145 Date standards. Various date standards exist in the information technology industry and there are many Year 2000 solutions. The subject of establishing a single standard has been debated within the information technology community.

12.146 A date standard has been in place in the Treasury Board Information Technology Standards since 1988. If the date standard had been followed by departments and agencies, system interfaces internal to the government would pose a lesser threat as a result of Year 2000. However, decreeing a standard for immediate adoption could jeopardize many Year 2000 projects already under way in departments and agencies. There would be merit in the government's promulgating established standards as a target for adoption in the longer term.

12.147 Test facilities. Departments and agencies need to plan ahead for the testing phase. There will be a need for a Year 2000 test environment, separate from a production environment. Many departments and agencies will not have excess processing capacity to create such test environments. There could be duplication in the use of resources if all departments and agencies were to acquire additional capacity for testing. Through testing applications and data files at central facilities, experience could be gathered to benefit other departments and agencies.

12.148 There would be merit in exploring the feasibility of creating test facilities that could serve some departments and agencies. The Secretariat's project office has identified as one of its initiatives a study of the feasibility of establishing a common test facility.

12.149 Legal implications. As of May 1997, analysis of the legal implications of Year 2000 had been primarily in the area of contracting and contract administration.

12.150 Limited work has been done to examine and analyze other possible legal implications for the government that may result from Year 2000. Possible scenarios to consider include:

- errors in government services and information upon which businesses or the public rely;
- interruption in services that result in delays, causing loss of business;
- malfunction of products or devices certified by the government; and
- defects, errors, interruption or failure of goods or services regulated by the government.

12.151 In our view, there would be merit in conducting legal analyses so that departments and agencies can receive guidance and advice on precautionary measures to take as appropriate. In late June, the Secretariat's project office identified legal issues arising from Year 2000 among its list of challenges for consideration.

12.152 Most of these opportunities and many others have been identified by the Secretariat. However, as of early May 1997, some initiatives were under way and others had yet to be started. In addition, no initiatives relating to date standards and legal implications were included in the proposed activities. If the opportunities are not pursued expeditiously, the centralized effort will lose its potential to serve departments and agencies.

12.153 The Treasury Board Secretariat should accelerate its work plan for Year 2000 and launch or expedite the projects in the plan. It should also assess the merit of initiatives concerning date standards and legal implications for inclusion in its work plan.

Conclusion

12.154 The Year 2000 issue can have a significant adverse effect on government programs and operations. The stakes for the government are high. In particular, systems that are most critical in supporting major programs may fail and could affect public health and safety and other essential services to the public. Aside from the direct fallout of systems errors or failures, Canadians' confidence in the public service may also be at stake.

12.155 Our audit of departments and our general survey showed that, as of the end of April 1997, most government departments and agencies were at early stages of their Year 2000 projects. We concluded that the rate of progress to date has generally been slow and that the residual risks to government systems remain high.

12.156 The present state of the government's readiness for Year 2000 is particularly vulnerable, given that there is limited time left to convert, test and implement systems. Using the emerging industry standard of allowing one calendar year for addressing delays and unanticipated problems, the government had only 20 months remaining at the time we completed our audit, and the magnitude of the task at hand can be overwhelming. Furthermore, there are formidable exposures ahead that can jeopardize the successful implementation of compliant systems, and substantive contingency plans have yet to be developed.

12.157 We are concerned that if progress were to continue at the rate we observed, it would likely be too slow to overcome the Year 2000 threat. Systems that support major programs and essential services may fail, and continuous delivery of these programs and services could be at risk.

12.158 In our view, there is a need for urgent and aggressive action on the part of the government, including engaging ministers and possibly parliamentary committees to champion Year 2000 projects. We also emphasize the need for substantive contingency planning to serve as a safeguard, particularly for major programs and essential services.

***Treasury Board Secretariat's response:** The government has accorded the Year 2000 issue the highest priority. An aggressive action plan of government-wide initiatives has been approved by the Treasury Board. The government is addressing common horizontal needs, including human resource and procurement issues to recruit and retain sufficient skilled personnel to undertake the required work. It is sharing best practices and methodologies to ensure maximum benefit from the work under way. It is also monitoring and reporting departmental progress on an ongoing basis to ensure that appropriate actions are being taken as required. The pace of government activities is accelerating and will continue to accelerate in addressing this unique challenge.*

With these actions the Treasury Board Secretariat is currently examining the state of readiness of all systems that support government services that the government deems 'mission-critical' to confirm that they will continue to function properly after 31 December 1999. Several steps are being taken by the Chief Information Officer Branch to understand and monitor departmental action plans for mission-critical systems, including the requirement that departments develop and submit contingency plans should such systems not be fully functional at that date.

The government generally agrees with the report's recommendations and acknowledges the Auditor General's contribution to greater awareness of this project.

About the Audit

Objective and Scope

The audit examined the risks and exposures that government programs and services face as a result of the Year 2000 threat. We reviewed the progress of Year 2000 projects at several departments to assess the government's general state of preparedness.

The audit serves to inform Parliament of the Year 2000 crisis and our assessment of the government's readiness in this regard and to prompt appropriate action on addressing critical systems and those that concern the interests of the Crown and the public. The audit also sought to identify and highlight issues and areas that require further attention from the government and Parliament in facing the Year 2000 challenge.

Nine departments were selected for examination — Agriculture and Agri-Food Canada, Correctional Service Canada, Department of National Defence, Health Canada, Human Resources Development Canada, Justice Canada, Public Works and Government Services Canada, Revenue Canada and Veterans Affairs Canada. The departments were selected because they deliver major programs and essential services to the public. Collectively, they also represent 32 percent of the government's budgetary expenditures and 94 percent of budgetary revenues forecast for 1996-97.

In order to gain a broader perspective on the state of preparedness across government, we also conducted a general survey of over 60 departments and agencies. They represent government organizations that are led by deputy ministers or those of an equivalent rank. The survey requested information and status as of 30 April 1997. About 50 responses were received; some did not address all the survey questions. We did not validate the responses provided by the participants.

We also examined initiatives undertaken by the Chief Information Officer Branch of the Treasury Board Secretariat to help mitigate Year 2000 risks to the government.

Criteria

Where appropriate, detailed criteria are discussed in sections corresponding to the observations and findings. The general criteria used in the audit are as follows:

- Leadership initiatives should be in place on a government-wide basis to address the challenge posed by the two-digit year coding practice in information technology as the year 2000 approaches, and to oversee progress in assessing and overcoming the challenge.
- At the departmental or agency level, there should be an organized plan and structure to secure senior management awareness and support, and to manage and contain risks in relation to the Year 2000 issue, including identifying and assessing risks and implementing and testing corrective action taken on systems, devices or facilities that may be affected.
- Initiatives should be in place to co-ordinate and facilitate Year 2000 efforts of departments and agencies to maximize their cost effectiveness.

- Management practices in addressing the Year 2000 issue should demonstrate due regard to economy and efficiency.
- Parliament should be kept informed of matters of significance arising from the Year 2000 challenge and its effects on government programs and service delivery.

Audit Team

Greg Boyd
Brian Element
Joe Lajeunesse
Maria Wisniowski

For information, please contact Nancy Cheng, the responsible auditor.

Chapter 13

Health Canada - First Nations Health

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Health Canada - First Nations Health

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ronnie Campbell

Main Points

13.1 First Nations health is significantly worse than that of the general Canadian population. The health status of the First Nations population is affected by poor socio-economic conditions, which present considerable challenges to Health Canada and others who deliver health services to First Nations.

13.2 The management of community health programs through separate contribution agreements needs improvement. Health Canada does not monitor contribution agreements effectively. Clear and detailed descriptions of the programs to be undertaken in specific communities were often not available. In about two thirds of the agreements we examined, the Department did not have the required information on the activities carried out in the communities.

13.3 A sound framework for the transfer of health programs to community control has been developed and has allowed First Nations to start managing their own health programs. However, this framework has not yet been fully implemented. Required reports seldom provide performance information related to health, and requirements for program audits were not adequately met. In addition, the evaluation of the transfer initiative did not include any measures of changes to health.

13.4 Significant weaknesses exist in the management of pharmacy benefits under the Non-Insured Health Benefits program, allowing clients to access extremely high levels of prescription drugs. Although the Department has been aware of the problem of prescription drug misuse for almost 10 years, we found no evidence that the ease of access to prescription drugs has changed in any significant way. Despite the seriousness of the problem and numerous reports of prescription drug addiction and prescription-drug-related deaths in First Nations communities, action to intervene has been slow.

13.5 In an attempt to address program weaknesses, Health Canada is currently testing a point-of-service system that is to be fully implemented in the fall of 1997. Such a system has the potential to be a key mechanism in the control of drug use and the administration of pharmacy benefits. However, the Department needs to provide a clear protocol to guide intervention and will need to closely monitor pharmacists' overrides of warning messages.

13.6 Dental care providers tend to provide services up to the established frequencies and limits rather than based on needs, resulting in overservicing of some First Nations clients. The Department has piloted a predetermination process and plans to implement this needs-based model for the dental benefit nationally.

13.7 The Department has successfully implemented some cost management initiatives, resulting in a reduction in the rate of increase in direct program costs for non-insured health benefits from 22.9 percent in 1990-91 to 5.6 percent in 1995-96. However, further savings can be achieved in other areas, including dispensing fees and medical transportation. In addition, management needs to strengthen verification of claims and audits of providers.

Introduction

13.8 Health is an important concern for all Canadians. Overall, the health of Canadians compares favourably with that of people in other countries. However, disparities exist within the Canadian population. In particular, the First Nations experience significantly poorer health than the overall Canadian population.

13.9 A multitude of factors influence the health of a population, including the First Nations. The availability of high-quality health care is one important factor in determining health status. Many players are involved in the delivery of a variety of health services and programs.

First Nations health is significantly worse than the general Canadian population's

13.10 As of March 1997, First Nations comprised approximately 640,000 status (or registered) Indians and Inuit as defined for the purposes of the *Indian Act*. This represents about 2 percent of the Canadian population. Approximately 60 percent of First Nations members live on-reserve and 40 percent live off-reserve.

13.11 There are glaring differences in health status between the First Nations population and the Canadian population overall (Exhibit 13.1). The *1996 Report of the Royal Commission on Aboriginal Peoples* refers to the health status of Aboriginal people as both a tragedy and a crisis. The National Forum on Health recently concluded that the health of Aboriginal people continues to be significantly at risk. Some of the gaps identified have narrowed over the past several decades; however, significant disparities remain. For example, the First Nations infant mortality rate dropped from 2.5 times the overall Canadian rate in 1979 to 1.7 times in 1987 and has remained at that level since then.

Exhibit 13.1

First Nations Health Status Indicators as of 1993

(compared with general Canadian population)

- Infant mortality - 1.7 times higher
- Life expectancy - 7 to 8 years lower
- Rate of diabetes - 3 times higher
- Rate of tuberculosis - 6.6 times higher
- Suicide rates for young people - 5 to 8 times higher

Source: Health Canada

Delivery of health services to First Nations presents considerable challenges

13.12 In addition to trying to address the significant gaps in health status, those who deliver health services to First Nations face other challenges. The population being served is geographically dispersed, often located in isolated communities. There are over 600 First Nations, that is, collectivities of status Indians and Inuit, some of which are made up of several communities. Many communities are located a considerable distance from cities and do not have direct or easy access to physicians and provincial health services. For example, there are 121 isolated communities with no road access, and an additional 75 communities that have road access but are more than 90 kilometers from the nearest physician. Further, many of the communities are small; about 75 percent have fewer than 1,000 members.

13.13 The health status of the First Nations population is affected by socio-economic conditions that, in many cases, are very poor. Exhibit 13.2 displays some of the important factors affecting First Nations health, according to Health Canada, the Royal Commission on Aboriginal Peoples, and the National Forum on Health. Those who deliver health services have no control over these factors that nonetheless impact on their ability to achieve desired results.

Exhibit 13.1

Major Socio-economic Factors Affecting First Nations Health

- Significantly lower levels of education
- Inadequate housing conditions
- High unemployment
- Low incomes
- Welfare dependency

Sources: Health Canada, Royal Commission on Aboriginal Peoples, National Forum on Health

13.14 There are a number of governments involved in the delivery of health services to the First Nations population, including the provincial and territorial governments, the federal government through Health Canada, and the First Nations local governments. There is a lack of a common view on their respective roles and responsibilities.

13.15 The provincial and territorial governments are primarily responsible for the delivery of health care services to the residents of their jurisdictions, including the provision of hospital and physician services. Some provinces have included First Nations in programs beyond basic services while others have not. The provincial and territorial governments consider that the federal government should accept full responsibility for all health programming for First Nations living on and off-reserve.

13.16 The federal government views health care as primarily a provincial responsibility. It considers that all residents of a province are entitled to provincial health services, including First Nations. It maintains that the federal government's provision of health services to status Indians and Inuit is based on policy and not on treaty or other legal obligations.

13.17 Most First Nations generally consider that all necessary health services must be provided to them under Aboriginal and treaty rights and, as such, represent a fiduciary obligation owed by the Crown.

Medical Services Branch delivers health services to First Nations

13.18 It is in this environment that Health Canada, through the Medical Services Branch, delivers health services to First Nations. The Branch, headed by an Assistant Deputy Minister, has a staff complement of approximately 1,800 full-time equivalents dedicated to this task. There are three key directorates at headquarters in Ottawa (First Nations and Inuit Health Programs; Program Policy, Transfer Secretariat and Planning; and Non-Insured Health Benefits) and eight regional offices (Atlantic, Quebec, Ontario, Manitoba, Saskatchewan, Alberta, Pacific and Yukon).

13.19 The objective of the Branch is to assist status Indians, Inuit and residents of the Yukon to attain a level of health comparable with that of other Canadians living in similar locations. The health services are provided through two programs: Non-Insured Health Benefits (NIHB); and community health programs. Expenditures for these services amounted to approximately \$1 billion in 1995-96 (Exhibit 13.3).

Exhibit 13.3

(This exhibit is not available, see the Report)

13.20 As a result of the 1994 federal Budget, program expenditures are required to be managed within a fixed financial envelope. Annual growth rates have been set at 6 percent in 1995-96, 3 percent in both 1996-97 and 1997-98, and approximately 1 percent in 1998-99. The Department has established regional envelopes, and there is flexibility for each region to move resources among programs within its allocation.

Community health programs are delivered in various ways

13.21 The community health programs consist mainly of programs and activities related to public health, health education and promotion, and strategies to address specific health problems such as alcohol and drug abuse. These are provided to First Nations individuals on-reserve. Exhibit 13.4 gives a brief description of five of the key programs: Nursing, Community Health Representatives, National Native Alcohol and Drug Abuse Program, Brighter Futures (also called Child Development Initiative) and Building Healthy Communities.

Exhibit 13.4

Community Health Programs

Program	Date Initiated	Description	Example of Activities
Nursing	1920s	Nurses are involved in a wide variety of roles, increasing with the isolation of the community. For reserves that are close to towns, the role of the nurse focusses on public health. For reserves that are isolated, nurses perform an expanded role, which also includes a certain amount of diagnosis and treatment of health problems and dealing with emergencies.	<ul style="list-style-type: none">• Provision of prenatal care• Visit to newborn babies and mothers• Immunization• Conduct of screening tests for children to identify problems early• Provision of health information in schools on dental care, nutrition, lifestyle, etc.• Emergency treatment (in isolated communities)
Community Health Representatives (CHR)	1960s	The CHRs are usually members of First Nations communities who often work with and assist the nurse in the community health activities. Their role has evolved over time and varies from one community to another.	<ul style="list-style-type: none">• Various workshops• Organizing gatherings and other events• Individual and group counselling• Education sessions in schools• Early identification of abusers• Referral to treatment• Aftercare and support following treatment
National Native Alcohol and Drug Abuse Program (NNADAP)	1982	The objective is to arrest and offset high levels of alcohol and drug abuse in First Nations and Inuit communities. This is done mostly through treatment in NNADAP facilities and through prevention at the community level.	
Brighter Futures	1992	The goal of the Indian and Inuit component is to encourage and support the well-being of children, individuals	

		and families. The program is organized into six components: mental health; child development; solvent abuse; injury prevention; healthy babies; and parenting skills.	
Building Healthy Communities	1994	The goal is to address needs not met by other programs. It includes three components: mental health; solvent abuse; and home nursing.	

13.22 The delivery mechanisms for community health programs have changed over time. Initially these programs were delivered directly by Medical Services Branch. Now they are delivered mostly through arrangements with First Nations organizations. The Branch uses three basic types of agreements that give First Nations varying degrees of flexibility, control and responsibility to design programs. In increasing order of flexibility, these are separate contribution agreements, Integrated Community-Based Health Services agreements and transfer agreements (see Exhibit 13.5 for details).

Exhibit 13.5

Characteristics of Arrangements for the Delivery of Programs

	Separate Contribution Agreement	Integrated Community-Based Health Services Agreement	Transfer Agreement
Flexibility allowed First Nations to design programs	Minimum	Medium	Maximum
Flexibility to First Nations to reallocate resources across programs	None	Medium	Maximum
Annual reporting requirements	<ul style="list-style-type: none"> • Separate activity reports for each program • Separate financial reports for each program 	<ul style="list-style-type: none"> • One activity report for all programs • Separate financial reports for each program 	<ul style="list-style-type: none"> • Annual report including mandatory programs • Comprehensive financial and program audit
Provision of funds for management	None (with some exceptions)	Medium (half that under transfer)	Maximum
Detailed monitoring by the Department	Maximum	Medium	Minimum
Accountability of First Nations to community members	Medium	Medium	Maximum
Accountability of First Nations to the Minister and of the Minister to Parliament	Same	Same	Same

13.23 The ultimate objective is to improve the health of First Nations through good programs and services at the community level. The type of arrangement chosen is not the end — it is only the means to achieve the end. Departmental data show that, as of 31 March 1997, approximately 27 percent of First Nations had signed a transfer agreement and 13 percent an integrated agreement. The remaining 60 percent were delivering programs under separate contribution agreements. Expenditures on community health programs and transfer agreements amounted to \$450 million in 1995-96 (see Exhibit 13.6 for a breakdown).

Exhibit 13.6

(This exhibit is not available, see the Report)

13.24 In March 1994, Health Canada directed Medical Services Branch to continue the devolution of its Indian health resources to First Nations control within a time frame to be determined in consultation with First Nations and Inuit communities, and to move out of health care service delivery. The Branch projects that approximately 60 percent of First Nations will be under transfer agreements by 1999-2000.

13.25 The Branch's delivery of community health programs is decentralized. Responsibility for the delivery of the programs rests mainly with the regional directors. The vast majority of staff involved in community health programs and the transfer process are in the regions.

A variety of non-insured health benefits are provided to First Nations people

13.26 Medical Services Branch pays for a number of health-related services such as pharmacy, dental and vision care that are provided to First Nations clients. In 1979, the federal government introduced an Indian Health Policy that established a framework for the delivery of all Indian and Inuit health programs. The goal of the policy is to achieve an increasing level of health in Indian communities, generated and maintained by the communities themselves. The program principles were subsequently established, specifying that benefits are to be provided according to medical or dental need or a comparable Canadian standard, and that the NIHB program is the payer of last resort.

13.27 The objective of the program, as indicated in a renewed policy mandate proposed by the Department in April 1997, is described in Exhibit 13.7. The program is not recognized in any legislation, but is provided by the federal government as a matter of policy. Parliament is asked each year through appropriation acts for the authority and resources to provide these services. Exhibit 13.8 shows 1995-96 NIHB expenditures by benefit category.

Exhibit 13.7

Non-Insured Health Benefits Program Objective

The purpose of the program is to provide non-insured health benefits to First Nations and Inuit people in a manner that:

- is appropriate to their unique health needs;
- contributes to the achievement of an overall health status for First Nations and Inuit people that is comparable with that of the Canadian population as a whole;
- is sustainable from a fiscal and benefit management perspective; and
- facilitates First Nations/Inuit control at a time and pace of their choosing.

Source: Health Canada

Exhibit 13.8

(This exhibit is not available, see the Report)

13.28 While the Non-Insured Health Benefits program is not subject to transfer at this time, some pilot projects aimed at examining future management options have been considered. Planning is under way with a view to obtaining appropriate authority to transfer the program to First Nations control.

Focus of the audit

13.29 We examined the way the Medical Services Branch manages health programs delivered to First Nations. The audit focussed on community health programs delivered through separate contribution agreements; the transfer of health programs to community control; and non-insured health benefits. Our examination included a follow-up of our previous audit of NIHB, reported in Chapter 19 of the 1993 Report. Further details on the audit scope, objectives and criteria are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Community Health Programs Delivered through Separate Contribution Agreements

Balancing the need for flexibility with fulfilment of obligations is a challenge

13.30 Medical Services Branch expects that communities with separate contribution agreements will implement activities that more closely follow the programs designed by the Branch. First Nations have some flexibility to tailor the programs to meet their needs, but within the program framework developed for each program. The Minister remains responsible and accountable to Parliament for the funds spent and the results achieved. The Department's challenge is to allow and encourage First Nations to tailor programs to meet their needs and, at the same time, fulfil its own obligations to manage programs efficiently and effectively.

13.31 The expectation is that officials will work more closely with First Nations under separate contribution agreements than with those who have transfer agreements. We expected that Medical Services Branch would know how a First Nation intends to spend program money and what it expects to achieve, would gather and review community reports on what has been accomplished, and would work constructively with the First Nation to help build capacity and improve programs and services.

13.32 We observed that although these elements are indeed reflected in the structure of most of the arrangements, the relationship in practice is quite different.

Overlapping of programs makes them difficult to administer

13.33 We found that many of the community health programs overlap and are trying to address the same problems. For example, both Brighter Futures and Building Healthy Communities include activities to improve the mental health and well-being of the community and are expected to reduce the high level of suicides. Solvent abuse is to be addressed specifically by parts of these two programs as well as the National Native Alcohol and Drug Abuse Program (see Exhibit 13.9).

Exhibit 13.9

(This exhibit is not available, see the Report)

13.34 The Department recognizes the need to manage the programs so that they complement each other. Branch officials in the regions have encouraged First Nations to consider related programs together, so that the various activities are co-ordinated in the community. In one region, the funds available from two programs were merged together in the agreements and Branch officials were prorating the reported expenditures. Nonetheless, these programs are delivered and accounted for separately. The overlap makes it confusing and difficult for both First Nations and Medical Services Branch to administer them as separate programs.

13.35 The Department is accountable for the programs it delivers, whether directly or indirectly through arrangements with third parties; it has to report to Parliament every year on program performance. Overlaps in programs increase the difficulty of attributing results to a specific program.

13.36 The Department should review its program structure and ensure that it reflects the manner in which the programs are actually delivered.

Department's response: Agreed. This recommendation will be discussed with Treasury Board officials.

Specific expectations and activities under agreements are often not clearly stated

13.37 The community health programs are designed to allow First Nations to tailor them to meet the needs of their communities. We expected that each First Nation would clearly define at the beginning of each year what it intends to do and achieve. This could be included in the agreement or provided in a separate workplan.

13.38 We found clear and detailed descriptions of the programs to be undertaken in specific communities in approximately 60 percent of cases for Brighter Futures and Building Healthy Communities and in less than 20 percent of cases for National Native Alcohol and Drug Abuse Program and Community Health Representatives (see Exhibit 13.10). In the latter cases, the only description available was often a generic one used for all communities in a given zone; it did not specify what a particular community was going to undertake. In about a third of the cases, for all programs, there were no clear descriptions of objectives and activities.

Exhibit 13.10

Assessment of Contribution Agreements

Program	Agreements with clear objectives and activities for the specific community	Agreements with activity reports
Community Health Representatives	15%	39%
National Native Alcohol and Drug Abuse Program	19%	32%
Brighter Futures	59%	32%
Building Healthy Communities	59%	27%
For all programs	38%	33%

Note: Based on an analysis of contribution agreements from 40 communities.

13.39 When we did find a specific program description, it usually included some health-related objectives and a list of activities to be conducted. About 80 percent of the cases gave no indication of how the community would know whether the activities were successful. Indicators such as participation rates for workshops or number of visits to elders were not specified.

13.40 The Department should ensure that the contribution agreements are clear about specific objectives and activities that the First Nation will undertake. It should encourage First Nations to define measures of success.

Department's response: Agreed.

Activity reports are not provided consistently

13.41 The contribution agreements usually require that activity reports be produced at the end of the year or periodically throughout the year. The activity reports can be valuable tools for the First Nation to review and improve programs, and for Medical Services Branch to ensure that the programs are managed efficiently and effectively.

13.42 For about 67 percent of the agreements we examined, the Department did not have the required activity reports (see Exhibit 13.10). In other words, the Department had none of the required information on the activities carried out under two thirds of the agreements. Departmental officials told us that they obtain knowledge of community activities more informally, through their periodic contacts with the health workers and visits to the communities.

13.43 We found that when activity reports had been produced they were mainly lists of activities. Some included information on services provided, such as the number of people visited or counselled and the rates of participation in activities. A small number also noted positive effects of the activity, such as the creation of a support group, and assessments that could be used to improve the activity in the future, such as providing for day care when information sessions are targeted to parents. This type of assessment needs to be encouraged.

13.44 **The Department should ensure that it receives the activity reports required under contribution agreements. It should work with First Nations to improve these activity reports so that they provide information on results achieved.**

Department's response: Agreed.

Management of contribution agreements needs improvement

13.45 We expected that the Branch would monitor contribution agreements to get the information it needs to fulfil its obligations and to help First Nations build capacity and improve management practices in their communities. This would provide the basis for First Nations to improve the programs and prepare to take on additional responsibilities under transfer agreements.

13.46 However, we found that Medical Services Branch does not monitor contribution agreements effectively. As we have already noted, a clear description up front of what is to be done and achieved and a report on performance at the end of the year were often not available. The Branch rarely took steps to clarify descriptions and obtain the required activity reports. Often, even when it has received these documents it has not reviewed them with a view to improving them in the future and improving the health services provided. Departmental officials mentioned that they visit communities and discuss issues with community workers, which allows them to know and influence what is being done. It is interesting to note that the good program descriptions and activity reports we saw were from the regions or zones where the Branch has asked for the required reports, thus reinforcing their importance, and where it has helped to produce them by providing a predeveloped reporting form.

13.47 The level of responsibility undertaken by a community is supposed to depend, in part, on the extent to which it has demonstrated its ability to manage that responsibility. However, the Branch has not taken the opportunity to build capacity by ensuring that management practices are in place in the communities to deliver these important programs.

13.48 Departmental officials are aware of cases where the provision of good-quality health services in the communities is hampered by inadequate management:

- In some cases, there is little or no supervision of band employees.

- In some cases, community workers delivering related services are working in isolation from each other.
- In some communities there are indications that the expected services are not being provided, given that some band-employed health workers are not working the required number of hours or are on extended leave and have not been replaced.
- In some cases, the competency or qualifications of some community workers have been questioned.

13.49 No clear action has been taken to solve these problems and to make sure that sufficient results are achieved with the funds provided. Other studies and reviews have reported similar concerns:

- The 1989 evaluation of projects in the National Native Alcohol and Drug Abuse Program noted that the majority of workers said they were not supervised and there were few prevention activities conducted at the community level, such as education sessions in school.
- A 1993 review of the Community Health Representatives Scope of Practice noted the lack of adequate training or of adequate numbers of trained personnel.

13.50 In summary, we found that the management of separate contribution agreements was weak. In the majority of cases, Branch officials did not insist that sound management practices be in place and that the required reports be produced. There was very little follow-up with First Nations to build capacity.

Transfer of Health Programs to Community Control

A sound transfer framework has been developed

13.51 The Department's objective in transferring health programs to First Nations control has always been to improve the health status of Indian people by allowing First Nations to assess their own needs and design programs to meet them. Under transfer agreements, the First Nations are no longer bound by the programs designed by Medical Services Branch and can sign agreements for up to a five-year period. Only the resources spent by the Branch on community health programs, and not those spent by provinces or other departments, can be included in the transfer agreements.

13.52 Under the transfer initiative, the Department encourages greater accountability by First Nations toward their communities, recognizing at the same time that the Minister of Health retains accountability for the use of public funds and for overall results. In order to meet the transfer objectives and also fulfil these accountability obligations, the Department in 1989 developed a transfer framework for specific agreements (see Exhibit 13.11). In addition, an evaluation of the transfer initiative was conducted jointly in 1995 by the Department and the First Nations involved.

Exhibit 13.11

(This exhibit is not available, see the Report)

13.53 We reviewed the transfer framework and found it to be basically sound. However, the take-up for transfer has been slow. In Alberta, for example, only one First Nation had signed a transfer agreement at the time of our audit. The evaluation of transfer noted that certain concerns of First Nations have presented real barriers to negotiating transfer agreements. These include concerns about the recognition of treaty rights and questions about the future roles and responsibilities of Health Canada.

Transfer has allowed First Nations to start managing their own health programs

13.54 During the pretransfer phase, First Nations developed their community health plans and defined the roles and responsibilities of the various staff, including the health director. Medical Services Branch considers that the community health plan is the key to a successful transfer, and it has defined a series of elements required in these plans. The majority of the plans we reviewed included many key elements (see Exhibit 13.12 for details).

Exhibit 13.12

Assessment of Community Health Plans

Selected elements required in the plan by the transfer framework	Plans that included the element
Identification and prioritization of the needs of the community	92%
Description of the programs to be undertaken	88%
Description of the role of the Medical Officer of Health	83%
Identification of the Medical Officer of Health	50%
Description of how the professional staff will be supervised	79%
Identification of the requirement for nurses to be registered in the province	67%

Note: Based on an analysis of community health plans for 24 of the 68 transfer agreements signed at the time of the audit.

13.55 More clarity is required in describing what the programs are intended to achieve. Consistent with the requirement of the transfer framework developed by Medical Services Branch, we expected that the community health plans would define the objectives of the programs and would indicate the health status data and results measures to be collected. We found that most plans defined broad objectives and included a corresponding list of activities. However, many did not clearly specify what was to be achieved, or how this was to be measured. This is an area that needs to be continually developed and improved.

13.56 During the negotiation phase, Medical Services Branch reviewed the majority of community health plans and discussed with First Nations various matters that were not covered in the plans. In that way, it encouraged First Nations to establish good practices. The transfer agreements stipulate that the health services are to be guided by the community health plan. We therefore expected that once the concerns had been resolved, adjustments would be reflected in the community health plans. However, we found that the community health plans were rarely updated to reflect the negotiated adjustments.

13.57 The transfer framework makes it clear that the community health plan, as a key planning document, should be updated regularly to keep it current. We expected that when renegotiating an agreement, usually after five years, Medical Services Branch officials would request and review the most recent update of the plan and use it as the basis of the renewed agreement. We observed that about three quarters of the renewed transfer agreements were based not on updated plans but on the community health plans developed at the beginning of the transfer process, more than five years earlier.

13.58 **The Department should ensure that updated community health plans that meet the basic requirements are prepared, and that they form the basis of both initial and renewed transfer agreements.**

Department's response: Agreed.

A transition period is important

13.59 Many regional officials stressed the importance of a transition period after the transfer agreement is signed, to allow the communities to learn about the programs. They mentioned that they need to spend a lot of time with the communities during that period because the communities often encounter difficulties or unforeseen challenges and seek help and advice from Medical Services Branch. Some departmental officials are concerned that as the Department's role changes, they may not be able to continue with the necessary capacity building. We believe that interaction between the First Nations and the Branch during the transition period is important and needs to continue.

Performance reporting needs to focus on results

13.60 The transfer framework recognizes the accountability of the Chiefs and Councils to their members and to the Minister, as well as the Minister's accountability to Parliament. The reporting requirements are designed to support all of these accountability relationships (see Exhibit). Therefore, the reports need to be useful to both the First Nations and the Medical Services Branch.

13.61 We believe it is important for managing and for accountability that the results of programs be measured to the extent possible and reported in sufficient detail. We expected that achievements would be reported in terms of services provided (such as immunization rates, attendance at particular workshops and events or number of clients counselled) and in terms of desired changes to health (such as reductions in the incidences of diseases, injuries, suicides or alcohol abuse). Both aspects are important, because some activities may appear to be successful without producing the desired change in health. For example, diabetes is a known problem in many communities; some First Nations are trying to prevent and control diabetes by providing information on the importance of factors such as nutrition and fitness. Such activities might be judged successful based on the number of people reached by the information. However, if this does not contribute to a reduction in the number of people with diabetes or an increase in the number of people controlling their diabetes, then the activities may need to be refocussed. More individual counselling, or more participatory activities such as walking clubs, might be considered.

13.62 The transfer agreements require First Nations to prepare an annual report to their communities summarizing the programs undertaken and providing data on services and their results. We found that most First Nations have prepared the required reports. Our examination of these reports showed that information on what has been done is given in terms of a description of the programs and, sometimes, measures of the services provided. However, the reports seldom include performance information related to health — that is, whether the desired changes to health are taking place.

13.63 The transfer framework requires that an evaluation of effectiveness be conducted by the First Nation every five years, and funds are provided for that purpose. Only four of the 24 agreements we reviewed had been in place for more than five years; two of those had not been evaluated. Three other First Nations conducted an evaluation much earlier than the end of the five-year period.

13.64 The transfer framework also requires these evaluations to assess whether the programs have achieved their objectives and produced the intended effects. We found that evaluations that have been undertaken have rarely measured the changes to health resulting from the programs. They typically reviewed the operations and the management of health programs. For example, some evaluations noted that the prevention and promotion activities were not conducted to the extent planned. This is useful information that can serve to improve operations. However, it does not satisfy the requirements of the transfer framework. We recognize that this is not easy. But there is a need to start working in that direction to see some practical progress in the short term and further progress over time.

13.65 The Department should work with First Nations to improve measurement of the services provided and of expected changes to health. These measures should be included in the annual reports. In addition, the Department should ensure that First Nations conduct the required evaluations of the achievement of program objectives.

Department's response: Agreed. It is important that a balance be achieved between reporting mechanisms designed so that First Nations program managers can be accountable to community membership while ensuring that information necessary for departmental accountability is provided. Work is currently under way to develop a new Accountability Framework for the Program, which will be appropriate for the increased control by First Nations through transfer and self-government. Associated performance and outcome measures will have a results orientation. This work will be done in conjunction with First Nations. It is expected that the work will be completed during the 1998-99 fiscal year and that it will be reflected in agreements signed after that.

The audit requirements were not adequately met

13.66 Under transfer, responsibility for the design and delivery of the programs rests with the First Nation. The transfer agreements require an annual comprehensive financial and program audit, with opinions on:

- fairness of the financial statements;
- adequacy of financial controls in place;
- compliance with the terms and conditions of the agreement; and
- provision of mandatory programs.

13.67 Such a comprehensive audit would inform Health Canada of the extent to which all conditions have been met, financial and non-financial. More specifically, it would allow the Department to assess performance with respect to mandatory program requirements.

13.68 For most First Nations, we found that an auditor's report concluding on the fairness of the financial statements was available; about half included all the financial operations of the First Nations and half were related specifically to health programs. However, only one of the agreements we examined had an audit opinion covering the other required aspects: adequacy of financial controls, compliance with the terms and conditions of the agreement, and provision of mandatory programs.

13.69 Some departmental officials told us that they were not clear on what the comprehensive audit is supposed to examine and what type of audit opinions are expected.

13.70 The Department should clarify the nature and scope of the audit requirements under transfer agreements and ensure that the required audit opinions are provided.

Department's response: Agreed. The Program will work with the Internal Audit Directorate of the Department to ensure that the audit requirements reflect the new accountability framework, emphasizing First Nations control, and that these are well understood by departmental officials and transferred communities.

The evaluation of the transfer initiative did not measure changes to health

13.71 In addition to the reporting required under specific transfer agreements, in 1995 the Department and First Nations conducted a joint evaluation of the transfer initiative. We found significant deficiencies in this evaluation.

13.72 Although it was expected to assess the impact of transfer on the health of First Nations, it did not include any measures of changes to health. We believe that such measurement, while difficult, is possible and should have been conducted. Without this information, it is not possible to determine whether transferring programs to First Nations control will in fact contribute to improved health, as is generally believed.

13.73 One of the difficulties is the absence of indicators of health that could be used in such an evaluation. One departmental official advised us that the joint evaluation committee will meet again in 1997 to determine how to measure changes to the health of First Nations after transfer, and that these measures will be used in the next evaluation.

13.74 The Department should ensure that future evaluations will determine the extent to which the transfer initiative contributes to improving the health of First Nations.

Department's response: Agreed. The development of measures to determine the impact of any one program or activity on health status has proved difficult for all health systems. Recent improvements in both methodology and technology will assist the Department to work with First Nations to produce useful and meaningful measurements.

13.75 In summary, we observed that the management of the transfer process has had some strengths; it has allowed First Nations to put in place management practices for their own health programs. However, some key reports have not been produced as required under transfer agreements and, in many cases, reports have not included the required information on performance.

Non-Insured Health Benefits

13.76 The NIHB program provides a range of health benefits and services that supplement provincial and third-party health insurance programs. As of March 1997, these benefits included prescription drugs, medical supplies and equipment, dental care, vision care, medical transportation, other health care services (such as physiotherapy and chiropractic care) and, in Alberta and British Columbia, medical insurance premiums. Benefits are provided to First Nations people living on and off-reserve. Direct program benefit costs increased substantially from \$307 million in 1990-91 to approximately \$505 million in 1995-96.

Risks associated with the program

13.77 The program provides benefits that are free, including prescription drugs, which can be misused or abused. Also, the program entails the processing of a large number of claims. Given these factors, the risks associated with the program include the following:

- some doctors may overprescribe medications to patients, using program resources;
- the costs of the program may escalate to an unsustainable level;
- some clients may access excessive levels of benefits;
- some clients may abuse or misuse prescription drugs;
- some dentists may overservice clients; and
- some providers may overbill for services provided to clients.

13.78 We would expect management to assess these risks, put in place appropriate controls, closely monitor the program and take timely corrective action when problems are identified.

Departmental concerns about physicians' prescribing practices

13.79 Most of the above are risks that the Department has the ability to address directly. However, this is not the case with physicians' prescribing practices. The Department is concerned that some doctors may be overprescribing mood-altering or central nervous system drugs to First Nations patients. The Department's own analyses indicate that some doctors are issuing very large numbers of prescriptions to NIHB clients.

13.80 The Department does not control or regulate the prescribing practices of doctors. However, departmental officials have raised the issue by communicating directly with some doctors. In some of those cases, departmental data show a subsequent reduction in prescriptions by the doctors. However, management is concerned that these changes may be temporary, and is frustrated by the limited success of this approach.

Cost savings are being realized

13.81 Direct program benefit costs rose more than 64 percent between 1990-91 and 1995-96. This was true for each of the major categories of benefit — pharmacy, dental care and medical transportation. Efforts to contain these increases have been under way since 1994.

13.82 While direct program benefit costs rose by more than 64 percent from 1990-91 to 1995-96, the annual increase was in fact down from 22.9 percent in 1990-91 to 5.6 percent in 1995-96. This was largely due to a number of ongoing departmental cost management initiatives, including a revised dental schedule and improved management of mental health counselling. In 1996-97, the Department was also successful in negotiating reduced premium costs in Alberta. Management has predicted a 3.2 percent decrease in direct program costs in 1996-97.

13.83 Savings have been realized in some areas but more needs to be done. The potential for savings exists in many other areas.

13.84 For example, a 1995 study by the Department estimated potential savings of \$5.7 million if dispensing fees paid by Health Canada for prescription and over-the-counter drugs were more in line with private sector plans. In most provinces, Health Canada pays a dispensing fee for over-the-counter drugs such as aspirin because NIHB clients require a prescription to obtain these drugs. In 1995-96, dispensing fees for over-the-counter drugs amounted to \$9.9 million, representing 44 percent of the total expenditures for these drugs.

13.85 Progress has been slow in negotiating dispensing fees with provincial pharmacy associations in some regions. As of March 1997, Health Canada continued to pay higher dispensing fees for prescription drugs than other plans in most provinces (see examples in Exhibit 13.13).

Exhibit 13.13

Prescription Drug Dispensing Fees

As of 31 March 1997:

- Health Canada paid \$8.85 in dispensing fees compared with \$6.47 paid by another federal agency and \$6.11 by the provincial government drug plan in Ontario.
- In Newfoundland, Health Canada paid \$7.90 in dispensing fees while pharmacies charged the provincial government drug plan for welfare recipients a mere \$3.92.

Note: Fees quoted represent maximum amounts charged per transaction.

13.86 As described in other parts of this chapter, improvements in monitoring the use of prescription drugs and medical transportation, audits of providers, and a system for predetermining dental benefits also have the potential to achieve savings. Given that funds are allocated by regional envelopes, savings realized in various areas represent an opportunity to redirect funds into other areas where they are needed most.

Significant weaknesses exist in the management of pharmacy benefits

13.87 Prescription drugs, over-the-counter drugs and medical supplies and equipment represent the largest NIHB benefit, with total expenditures of about \$157 million in 1995-96.

13.88 Program directives and guidelines specify that prescription drug benefits are available free to First Nations members if the item is not available to the client under other health plans and is considered medically necessary, that is, prescribed by a qualified physician or dentist. Over-the-counter drugs also require a prescription to be eligible under the program. The Department does not require a co-payment or deductible for the benefit.

13.89 As described in Exhibit 13.14, NIHB clients are required to obtain a prescription from a physician or, in some cases, a dentist in order to obtain free prescription drugs and over-the-counter drugs. Physicians have to rely on the NIHB patient to disclose drug use and visits to other doctors when they prescribe the medications.

Exhibit 13.14

Overview of the Prescription Drug Process under Non-Insured Health Benefits - Roles and Responsibilities of Parties Involved

Prescribers (doctors/dentists)	First Nations individuals	Providers (pharmacists)	Contractor for Health Canada	Medical Services Branch
<ul style="list-style-type: none"> • prescribe medications to First Nations patients • specify “no substitution” where appropriate • request information on other prescriptions 	<ul style="list-style-type: none"> • obtain a prescription for prescription drugs and over-the-counter drugs • provide an acceptable client identification number to pharmacist 	<ul style="list-style-type: none"> • request information on client identification and other coverage • dispense drugs based on written/verbal prescription • submit claims to Health Canada contractor 	<ul style="list-style-type: none"> • process and verify claims • verify that services are received by NIHB clients • pay providers and invoice MSB for services • maintain audit control of providers 	<ul style="list-style-type: none"> • responsible for managing the program • ensure that contractor complies with contractual requirements • provide funds to contractor for payment of provider claims and operations

13.90 Pharmacy providers dispense prescription drugs based on either a written or verbal prescription. Unless otherwise preauthorized, Medical Services Branch has established a three-month supply as the maximum quantity that can be dispensed at a time. Before a prescription is dispensed, the patient has to tell the pharmacist his or her name, date of birth and a client identification number. The client identification number can be an Indian registration number, a band number and family number, or a number issued by the Branch. However, the patient does not have to provide a complete address.

13.91 Currently, pharmacy providers are not connected to a system or network that provides information on the prescription drugs obtained by the NIHB client. They cannot tell whether the patient has gone to different doctors or

visited other pharmacies to obtain prescription drugs. However, pharmacy networks do exist and are being used by several provinces to administer their drug benefit programs.

13.92 In 1987, the Department entered into a contract with a private sector firm to develop and operate a claims-processing system for dental accounts. Since April 1990, the Department has had a second contract under which the contractor has developed and operated a similar automated system to process claims for the pharmacy component of the program. The Department assures us that the system was developed by the contractor to be consistent with industry standards and practices comparable with other drug benefit plans.

13.93 Pharmacy providers submit their claims (approximately 5.8 million transactions in 1996) directly to the contractor to be reimbursed for pharmacy benefits dispensed to NIHB clients. These claims contain details on the NIHB client, the identification of the prescriber, and the date and description of the drug dispensed. However, the claims are not accompanied by supporting documentation, such as copies of prescriptions. The contractor advises us that this is consistent with industry practice. Thus, the contractor is not able to review any supporting documentation before reimbursement to verify that there is a valid prescription or that the client has received the benefit.

13.94 Health Canada pays the contractor for services rendered and provides funds to cover anticipated claim payments to providers. It does not verify documentation supporting the claims before paying the contractor.

13.95 The process contains a number of weaknesses. The claims filed do not include addresses of the individuals to whom services have been provided. The Department sees this as a hindrance to contacting the individuals directly to confirm that they have received the benefits. Pharmacists do not have access to information on patients' prescription drug use, the contractor does not receive and verify supporting documentation before paying providers, and the Branch does not review supporting information before paying the contractor. Further, as described in a later section, the audit regime is weak.

13.96 In addition, no thresholds have been established at which management could intervene in a timely way and query claims that indicate potentially inappropriate drug use patterns. The Branch does maintain detailed information, but this is reviewed retrospectively and anomalies are identified after the fact.

13.97 These flaws have contributed to an environment where abuses of the prescription drug benefit occur, as the following section explains.

The program allows clients to access excessively high levels of prescription drugs

13.98 We reviewed departmental data and found that some First Nations individuals were receiving large amounts of prescription drugs. Management believes that misuse of prescription drugs has been occurring for some time.

13.99 Prescription drug abuse refers to the use of a drug in a manner that deviates from use generally accepted by the medical community as appropriate in the circumstances in which it is prescribed. It includes the inappropriate prescription of drugs by physicians, the misuse of prescribed drugs by the patient, and the practice of visiting different doctors to get prescriptions and "shopping" pharmacies to obtain prescription drugs.

13.100 The Department has been aware of the problem for almost 10 years. However, we found no evidence that the ease of access to prescription drugs has changed in any significant way. Departmental data showed cases where individuals had accessed extremely high quantities of mood-altering drugs over short periods of time.

13.101 In fact, some of the amounts were so high that departmental reviews of individual drug use profiles raised serious questions about whether the individuals were actually taking the prescription drugs obtained or were using them for other purposes. This is because the amounts obtained were several times the recommended maximum

dosage limits. In some cases, a medical officer noted that the patients concerned would likely be unconscious or non-functioning if the drugs were taken as prescribed. Yet these individuals continue to claim, and the Department continues to pay, for excessive amounts of prescription drugs.

13.102 We performed an analysis of departmental data on prescription drug use for a three-month period, analyzing not only the number of prescriptions that individuals received but also the numbers of different drugs received and doctors and pharmacies visited. Because Health Canada had developed few criteria to monitor prescription drug use, we used criteria established by some provincial bodies.

13.103 The data for the three-month period showed that over 15,000 NIHB clients went to 3 or more pharmacies to obtain prescription drugs. Nearly 1,600 NIHB clients obtained more than 15 different prescription drugs and over 700 clients got 50 or more prescriptions. The results of our analysis are shown in Exhibit 13.15.

Exhibit 13.15

Analysis of Access to Prescription Drugs by Non-Insured Health Benefits Clients

First Quarter of 1996

Region	Number of clients going to 3 or more pharmacies	Number of clients getting over 15 different drugs	Number of clients getting at least 50 prescriptions
Pacific	1,931	107	97
Alberta	5,354	867	387
Saskatchewan	2,960	199	22
Manitoba	1,991	129	37
Ontario	1,728	121	63
Quebec	373	39	84
Atlantic	678	137	20
Total	15,015	1,599	710

Notes:

1. Total eligible clients at March 1996: approximately 620,000.
2. Number of drug claimants in all regions during period: approximately 257,000.
3. The following criteria (for a 90-day period) are used by some provincial bodies to identify cases for review:
 - going to three or more pharmacies to get prescription drugs dispensed
 - obtaining more than 15 different prescription drugs
 - obtaining 50 or more prescriptions

Source: Health Canada

13.104 As mentioned earlier, information systems allow management to review data retrospectively. However, the system does not use thresholds indicating what levels of drug use are reasonable, what levels require further explanation, or what levels the Branch would consider to be excessive.

13.105 The Department acknowledges that a contributing factor is “doctor shopping” — individuals visit a number of doctors, enabling them to obtain a large number of prescriptions. Departmental data showed that some individuals obtained similar prescriptions from several doctors within a short period of time. However, the field

identifying the doctor, which can be a name or a number, is not subject to any edits and accepts anything that is input. Due to the existence of many anomalies, inconsistencies and errors, it was not possible to accurately determine the extent to which doctor shopping occurs.

Serious implications for First Nations health

13.106 Although prescription drug misuse is not unique to First Nations, the seriousness of the problem and the implications for First Nations health are significant, particularly when the program is intended to improve the health of First Nations.

13.107 Between 1986 and 1996, there were numerous reports of prescription drug addiction and prescription–drug–related deaths of First Nations individuals in several provinces. In Alberta, for example, the Medical Services Branch regional office identified a total of 42 prescription–drug–related deaths in First Nations communities during 1986–88. Subsequent media reports indicate that serious problems still exist. This includes one community of 500 people where 15 such deaths were reported to have occurred in four years.

13.108 We reviewed Branch data and found that the prescription drugs most frequently obtained by NIHB clients are central nervous system drugs, such as acetaminophen with codeine and benzodiazepines. A number of medical studies have found that excessive use of certain mood–altering drugs causes serious side effects and withdrawal reactions. They include sedation, impaired memory, decreased cognitive agility, insomnia and visual disturbances. Although these studies are not specific to First Nations, they point to the consequences of excessive use of these drugs.

Action to intervene has been slow

13.109 Health Canada maintains that, while it is important to remember that prescription drug misuse is a problem that affects many Canadians and is not limited to First Nations, the Department does recognize the seriousness of the issue. It has established working groups to develop strategies and has initiated procedures to review prescription drug use in various regions. However, action to intervene has been slow.

13.110 According to the Department, a major reason for its inability to take prompt action was that systems were not sufficiently developed to analyze the pharmacy claims database. A departmental interdisciplinary working group on prescription drug abuse recommended in September 1988 that the prescription drug claims–processing system be automated and screening criteria be developed to monitor prescription drug use.

13.111 However, Health Canada’s automated claims–processing system was not fully operational in all regions for the pharmacy component until July 1993. As the system was designed mainly to process claims, some Branch regional officers noted their repeated frustration that the NIHB program had been able only to pay bills rather than to help provide solutions to the prescription drug abuse problem.

13.112 Not until 1996 did Health Canada start to develop software to analyze prescription drug use. Drug use review activities were piloted in three Medical Services Branch regions in 1996 and confirmed the nature of the problem. However, these reviews have been retrospective and have not facilitated timely intervention.

13.113 Health Canada’s intervention is primarily in the form of notification to physicians, pharmacists and professional bodies; it does not contact the NIHB client at all. Some NIHB clients continue to have access to large amounts of prescription drugs. We believe that contacting the client could have a deterrent effect and could potentially encourage changes in the client’s behaviour. It would also present an opportunity to provide help and information to those faced with addiction problems.

13.114 In cases where it identifies a significant pattern of inappropriate use of prescription drugs, the Department should perform a more rigorous follow-up with NIHB clients, physicians, pharmacists and professional bodies.

Department's response: Agreed. A protocol has been developed to guide departmental staff to follow up on patterns suggestive of prescription drug misuse.

Need for comprehensive solutions

13.115 In an attempt to address program weaknesses, Health Canada is currently testing a point-of-service system that is to be fully implemented in the fall of 1997.

13.116 Point-of-service systems for prescription drugs or pharmacy networks have been implemented by some provinces as a key mechanism to control drug use and administer benefits. Such a network can enhance patient care through more-informed decision making by the pharmacist, reduce fraud and the overconsumption of prescription medications, and improve claims adjudication.

13.117 In such a network, when a pharmacist enters the details of a prescription on an in-store computer, the information is transmitted electronically to a central system that assesses the prescription against the patient's recent medications. The system generates warning messages such as drug-to-drug interactions, overmedication, visits to several doctors and pharmacy shopping. Some systems also provide a full profile of all recent medications dispensed to an individual during, for example, the previous 14 months. Pharmacists are required to respond to warning messages and decide whether intervention is necessary. Some provinces offer an incentive for this, such as paying a double dispensing fee to compensate providers for professional services in cases where they have not filled a prescription for valid reasons.

13.118 The system being tested by Medical Services Branch will provide a set of system-generated messages and warning codes. It will also provide the dates of the last three prescriptions of the NIHB client. Pharmacists are expected to make dispensing decisions in response to warning messages, and the system will allow overrides.

13.119 The planned system will not provide a patient's full drug profile or complete information on doctors visited at the time of dispensing. Management notes that there are difficulties that would delay implementation of this feature nationally; however, it intends to strengthen the warning messages issued to pharmacists. Because the system will allow pharmacists to override warning messages, Health Canada will need to monitor this closely. The Department also needs to consider providing incentives to pharmacists to encourage appropriate intervention.

13.120 In implementing the point-of-service system for prescription drugs, the Department should ensure that the system will facilitate timely intervention where potentially inappropriate prescription drug use is identified. The Department should provide a clear protocol to guide intervention and should closely monitor pharmacists' overrides of warning messages.

Department's response: Agreed. The real-time pharmacy point-of-service system will be installed nationally by the end of 1997. A systematic audit of overrides will be used to gauge compliance and follow-up measures will be developed to deal with situations where compliance problems are identified. Payment incentives for pharmacists who decline to fill prescriptions in response to the alerts will be discussed during fee negotiations with provincial pharmacy associations. Despite the complexities associated with developing a fully portable, national system, the Department believes that this system will be superior to that of almost every other comparable provincial or private plan in the country.

13.121 Full implementation of a point-of-service system will not in itself solve prescription drug misuse problems. Tightening up controls is only one aspect. Health Canada will need to be concerned about additional problems potentially generated by controlling access to prescription drugs under this program.

13.122 Health Canada needs to examine the implications and resource requirements for community health programs with respect to treatment, community education and prevention of prescription drug addiction in First Nations communities. Prescription drug addiction has created other health problems, and the Department is concerned that many First Nations individuals have a combined drug and alcohol problem. Treatment in one area may aggravate the problem in the other. In addition to detoxification, patients may require further treatment and aftercare. Training community health workers to deal with prescription drug abuse is also important.

13.123 **The Department should build on its existing strategies to address the combined problem of prescription drug and solvent and alcohol abuse, and increase efforts in community health programs relating to prevention, community education, and treatment of prescription drug addiction.**

Department's response: Agreed. The Department is developing educational materials to inform First Nations and Inuit people of the correct use of prescription drugs and to alert them to the problems of prescription drug misuse. An educational video on this subject will be distributed to all First Nations and Inuit communities by the end of 1997-98.

Overservicing by dental care providers

13.124 Another major NIHB benefit is dental care. Dental expenditures increased from \$74 million in 1990-91 to approximately \$123 million in 1995-96. The dental benefit is governed by a schedule of dental services that sets out frequencies for various services.

13.125 We found that the dental care providers tend to provide services up to the established frequencies and limits rather than based on needs, resulting in overservicing of some NIHB clients.

13.126 In 1995-96, one Medical Services Branch regional office set up a joint quality assurance committee with a provincial dental body. The committee analyzed the profiles of a number of dental care providers and believed that overservicing by certain providers was occurring. Departmental data showed that levels of dental services by these providers were often many times above those of an average practitioner in that province. Some examples are shown in Exhibit 13.16.

Exhibit 13.16

Overservicing of Dental Procedures

Examples of dental services provided to First Nations clients in one province in 1994-95:

- One dental provider billed \$25,000 for 58 root canal therapy procedures, about 12 times more than an average practitioner performed in the province.
- Another provider charged \$40,000 for 92 crowns, more than six times the provincial norm.
- A dentist claimed \$27,000 for 356 coloured surface restoration procedures, about 40 times the average for such procedures performed by a dentist in the province.

Source: Health Canada

13.127 In January 1996, Health Canada introduced changes to its benefit schedule by establishing revised frequencies and limits, in an attempt to control costs while maintaining the provision of high-quality dental care. Some of these changes were made in response to concerns about overservicing. The changes were implemented

nationally. However, the Manitoba regional office indicated that the changes had been proposed unilaterally with little input from First Nations, and that they were contrary to common means of controlling costs used by other dental plans.

13.128 A predetermination process based on needs was piloted in Manitoba in April 1996. It requires prior approval and a treatment plan for performing dental services above a prescribed threshold amount. The needs-based approach is to ensure that First Nations clients receive the dental care they require. Preliminary results showed substantial cost savings. Management estimates that these savings, combined with those generated by the changes to the benefit schedule, will result in a 15 percent reduction of dental costs in 1996-97.

13.129 In January 1997, the departmental Dental Care Advisory Committee, which includes representatives from the First Nations and professional bodies, recommended that senior management approve the use of the predetermination model nationally by the end of 1997 as an intermediate solution. The Committee believes that this would provide the stability and time required for the Department to consider further improvements. Branch senior management subsequently agreed to implement such a model in all regions except Ontario, where the issue is still being discussed.

13.130 In our view, a predetermination process requiring prior approval and a treatment plan provides a good control framework for dental benefits. We noted that it has been used by other dental plans and endorsed by the profession in some provinces. In 1996, we reported that Veterans Affairs had implemented such a process for its dental care program and achieved significant savings.

Overbilling of services by providers

13.131 We expected to find adequate systems and controls in place for the verification of claims and audits of pharmacy and dental care providers to provide assurance that expenditures have been made for the purposes intended.

13.132 Claims for prescription drugs and dental services submitted by pharmacy and dental care providers are processed using an automated claims-processing system managed by Health Canada's contractor. The contract, implemented in 1990, expires in June 1998.

13.133 According to the statement of requirements in the contract, the contractor is required to "provide audit control on health service providers for the purpose of detecting and dealing with billing irregularities." Also, the contract states that there must be a method of verifying the integrity of the process to ensure that prescribers and providers are legitimate and that services paid for by Health Canada have in fact been received by NIHB clients. However, the contractor does not perform any procedures to confirm that benefits have been received by clients.

13.134 Edits are in place to identify apparent duplicate claims. Management believed that these edits were designed in such a manner that they would identify and alert management to any potential duplicate payment. However, we identified over 5,500 claims that appeared to have been paid twice (with a potential overpayment of \$166,510) in the year 1996. We also identified 160 transactions in a three-month period that suggested that the same prescription was filled at more than one pharmacy on the same day. Management recognizes these weaknesses and is now attempting to have the contractor strengthen these systems controls and edits.

13.135 Although the contract was initiated in 1990, no audits of providers were undertaken before the summer of 1995. Of approximately 6,500 pharmacies and 18,000 dental care providers, only 47 pharmacy audits and 13 audits of dental providers were performed over 18 months in 1995 and 1996. Some planned audits of dental care providers were not carried out because of providers' concerns about the contractor's right to audit them.

13.136 All audits of dental care providers found questionable billings. One audit, which found that a dentist had inappropriately charged for tooth extractions and other procedures, resulted in a repayment of approximately \$20,000 to Health Canada. Another provider repaid the Department over \$15,000, billed for a specific or emergency examination along with routine procedures such as preventive cleaning. In addition, a review by one Branch regional office led to the conviction of a dentist for billing both the Department and a provincial plan for dental treatment to NIHB clients covered under both plans. This resulted in a repayment of more than \$30,000 to Health Canada.

13.137 Approximately 90 percent of the pharmacy audits performed found errors and discrepancies such as duplicate claims, lack of documentation for verbal prescriptions and questionable record-keeping practices. Some cases involved suspected fraudulent practices that were referred to the appropriate authorities for investigation. One case resulted in restitution of more than \$77,000 from the provider.

13.138 We found that the audits of providers did not provide a reasonable degree of assurance that expenditures were made for the purposes intended. The audit strategy was not based on an appropriate assessment of risks. Audits were targeted mainly at a small number of high-volume providers. The Department believes that it is very difficult to require the contractor to increase the audit effort, due to the vagueness of the contract's wording. Because of the limited audit coverage, it is not possible to determine the full extent of errors and overpayments. However, the findings raise serious questions about the potential loss of public money.

13.139 Audits of providers are intended to be a key control relied on by Health Canada to ensure that payments are properly made for benefits and services received by its clients. Therefore, it is important that the requirement in the contract is clear, that the Department knows what is being done and what errors are being found, and that, as appropriate, it adjusts its reliance on the work of the contractor.

13.140 Health Canada should clarify, and enforce, the contract requirement for audit of pharmacy and dental care providers by the contractor. The Department should take appropriate steps to improve claims-processing system controls and edits and strengthen verification of claims and audits of providers.

Department's response: Agreed. In common with other plans, there must be an assessment of the risk in order to strike a balance between ensuring client access to necessary therapies and control of potential abuse. Improvements have been made to the audit portion of the new claims-processing contract, to be in place by July 1998. The Department is investigating the claims-processing errors identified by the Auditor General and is instituting immediate corrective measures. Efforts are under way to improve verification of claims and provider audits under the existing contract.

Opportunities to improve efficiencies in medical transportation

13.141 Medical transportation expenditures increased from approximately \$85 million in 1990-91 to almost \$150 million in 1995-96. The benefit includes transportation to receive health services that cannot be obtained on-reserve, medical transportation from isolated communities, emergency transport to non-elective care, and community-based transportation to the nearest major centre. Approximately 60 percent of transportation expenditures are administered by Medical Services Branch regional offices with payments made directly to providers by Health Canada. The other 40 percent of expenditures, mainly for local medical transportation, are administered by First Nations communities on behalf of the Department under contribution agreements.

13.142 There are many grey areas in the national directives on transportation, which have led to different interpretations and applications by Branch regional offices. We found inconsistencies in the requirement for certification of attendance at a doctor's appointment and in payment for similar items in different regions.

13.143 Ambulance costs accounted for substantial expenditures in some regions. At the time of our audit, there was no rigorous ongoing monitoring of these expenditures. Departmental officials in some regions have undertaken ad hoc reviews of ambulance costs, the results of which confirm the need for tighter control.

13.144 For example, one region paid about \$8 million in 1995-96 for services to approximately 125 ambulance companies. A regional internal review of invoices submitted by three ambulance companies found many cases of inflated distances, invoices received for individuals not eligible for coverage, an inappropriate surcharge of \$100 being levied on First Nations members living off-reserve, and ambulances used as taxis rather than for emergencies.

13.145 Another regional office also performed a limited review of ambulance costs, which identified cases of potential abuse that had gone undetected. In one such case, a client had taken 150 ambulance trips costing over \$21,000 during a five-month period. No one had questioned the trips until they were identified by the internal review.

13.146 While expenditures administered by First Nations communities under contribution agreements are often audited, transportation expenditures paid directly by Medical Services Branch to transportation providers have not been subject to any departmental audits in recent years.

13.147 Management is aware that improvements are required in management practices and in the control of medical transportation costs. For example, some regional program managers agreed that there is a need for better co-ordination of trips to achieve efficiencies.

13.148 Health Canada believes that transportation efficiencies can best be achieved at the community level. It has proposed moving medical transportation funding from the NIHB program to community health budgets. Such a change will require clear program criteria and mandatory elements, standards and audits.

13.149 **Health Canada should establish clear program criteria and minimum standards for medical transportation benefits. It should also undertake audits of medical transportation expenditures based on an assessment of risks.**

Department's response: Agreed. The Department is pursuing a course of action to address these problems. Cabinet has approved the move of medical transportation from NIHB to community programs. The requirement to establish program criteria and minimum standards will be addressed as the management framework is developed. This will be done in consultation with First Nations and Inuit groups. The Department will also increase the audit activity with regard to medical transportation.

Need to resolve systemic problems before transfer of NIHB program

13.150 In 1995, Medical Services Branch planned to implement 30 pilot projects across Canada over a two-year period to test various future management options for the NIHB program, including management by the communities. To date, 22 proposals have received a negotiating mandate but few have been approved for pilot implementation. Only one pilot is under way.

13.151 As already described, significant systemic problems and weaknesses exist in the program, particularly relating to prescription drugs and dental benefits. There are also other important issues that need to be addressed, including concerns of off-reserve clients and small communities, sustainable funding and the impact of the delisting of provincial insured services. In addition, Health Canada needs to evaluate the results of the transfer pilots.

13.152 As noted earlier, planning to transfer the NIHB program to First Nations control is under way. In our view, any transfer initiative must recognize the weaknesses identified and assign responsibility for fixing them.

Important concerns remain from previous audit

13.153 In our 1993 audit of the Non-Insured Health Benefits program, we examined the mandate, management practices and operational controls of the program.

13.154 We reported that the absence of specific enabling legislation for the program left a gap in the definitions of purpose, expected results and outcomes of program benefits. We recommended that the Department seek from the government a renewed mandate for the program to clarify the authority base, purpose and objective of the program.

13.155 We also noted that the Department had problems in implementing the principle of “payer of last resort”. Health Canada paid for benefits that it should not have because First Nations clients involved were not fully obtaining the benefits available from other plans. This section contains our observations as a result of the follow-up.

13.156 Program mandate. The renewed policy mandate proposed in 1997 defines the nature of the program, including its purpose and objective as well as the principles governing it. However, it does not address the need to clarify the authority base for the program. There is still no specific legislation recognizing non-insured health benefits. Further, the Department has yet to identify expected results of program benefits.

13.157 Principle of payer of last resort. The Department has noted that the principle is difficult to enforce in the absence of enabling legislation and given that provincial and private health insurance plans also claim to be payers of last resort. In practice, declaration of third-party coverage by NIHB clients is entirely voluntary and it is left to the service provider to identify any such coverage. A recent departmental audit suggested that there is a significant gap between the number of NIHB clients who have other coverage and the two percent of clients who actually declared other coverage when they received NIHB benefits.

13.158 A departmental working group has proposed several recommendations with a view to addressing our 1993 concerns. A number of them are currently being implemented. However, the working group is of the opinion that substantive improvements in the co-ordination of benefits with other insurance plans will be realized only when issues relating to treaty rights have been resolved.

13.159 The new program mandate proposes that where a benefit is covered under another plan, Health Canada will act as the “primary facilitator”, co-ordinating payment to ensure that the other plan meets its obligations and that clients are not denied service. However, the Department indicates that the proposed principle does not detract from its position that NIHB is the payer of last resort. Nor does it expand or limit different understandings of federal responsibilities under the “fiduciary relationship”.

13.160 Management information systems. In 1993, we reported that the NIHB program lacked the information systems and capabilities necessary to monitor and analyze patterns of benefit expenditure and use. The Department has applied considerable effort to improve its ability to monitor patterns of use of pharmacy and dental benefits. However, we found that the Department still did not have adequate systems to monitor and analyze these patterns for medical transportation and allied health care benefits.

Department’s comments: Over the past three years, the Department has commissioned three separate evaluations of the program and has drawn on the recommendations of these studies to design its current cost management approach. In the past six years, the Department’s cost management measures have achieved a total saving of more than \$1.3 billion. This has been achieved without diminishing in any significant way the level or quality of the benefits, despite the upward pressure of a client base growing at twice the rate of the Canadian population and the increasing costs of such benefits as prescription drugs.

Since 1993 the Department has taken a number of very important steps in order to address the problem of prescription drug misuse. These include the development of a fully automated claims-processing system, authorization to exchange information on possible irregularities with professional disciplinary bodies, establishment of a Drug Utilization Review Committee, which, among other things, has developed a protocol to identify patterns of possible misuse, and development of a software system to analyze patterns of prescription drug usage. We believe that the Department has been at least as active, and in some cases more active, than the managers of similar programs in taking advantage of new technology to improve the management of the system.

The Department has addressed all three of the recommendations from the 1993 audit. Work continues on ways to improve co-ordination with provincial and other third-party payers. In 1993 we stated that we would seek Cabinet approval of the program's mandate and this was obtained in April 1997. It is the Department's view that, through Cabinet, the authority base of the program has been clarified.

Conclusion

13.161 Follow-up. Health Canada is taking action to address our 1993 observations and recommendations. However, the Department needs to further improve its management information systems and co-ordination of benefits.

13.162 Community health programs. Based on our examination of programs delivered under separate contribution agreements, we found that once the contribution agreements are signed, the link between the Department and the community tends to disappear. The contribution agreements are viewed primarily as a means of transferring funds and, to a lesser extent, as an agreement between the two parties on the provision of health services to the First Nations population, for which the Department remains accountable. The Department is not fulfilling its responsibilities to manage in a way that helps First Nations establish programs and services likely to improve their health. There is a need to monitor contribution agreements in a way that will give First Nations flexibility and control to tailor programs to meet community needs and, at the same time, fulfil the Department's obligations.

13.163 Transfer agreements. We found that a sound framework for transfer has been developed but not yet fully implemented, leaving some gaps and deficiencies. More focus on achievements related to health is needed, in both the planning and reporting phases. Sound monitoring is needed to make sure that the management practices put in place in the pretransfer stage continue to evolve, and that the required reports are produced and provide the necessary information. These are needed to meet the accountability obligations of First Nations and the Department and also to improve the programs and services.

13.164 Non-insured health benefits. We found that NIHB program expenditures are not well managed and, in most areas, not properly controlled. Benefits are subject to abuse by users and providers, and systems and controls, including verification of claims and audits of providers, are inadequate. In particular, the Department needs to deal with the serious implications for First Nations health and the consequences of not having a properly controlled system in place.

13.165 It is vital to put proper controls in place to ensure appropriate use of the benefits and prudent use of public funds. There is also an urgent need for comprehensive solutions to address the abuse of the prescription drug system, through better use of information technology and concerted efforts with physicians, pharmacy providers and First Nations. Before any consideration is given to transferring NIHB to First Nations control, these systemic problems will need to be resolved.

13.166 A final note. The current trend in Health Canada is to continue devolution and to move out of health care service delivery. Many First Nations members are concerned about a "dump and run" approach: they are worried

that First Nations will be left on their own without having acquired the needed capacity to design and manage these important programs and without support from Medical Services Branch.

13.167 Improving the health of First Nations is a complex task. There are many governments involved and many factors that affect health outside of the health care services. This audit examined only the programs that the Medical Services Branch of Health Canada delivers either directly or in partnership with First Nations organizations. The chapter therefore presents only a part of the total picture. We believe that improving the programs in the ways we have recommended would contribute to improving the health services and thereby the health of First Nations.

Department's comments: The Department is aware that some First Nations people are concerned that we intend to take a "dump and run" approach to devolution and transfer. The mission statement of Medical Services Branch states that "First Nations and Inuit people will have autonomy and control of their health programs and resources within a time frame to be determined in consultation with First Nations and Inuit people." The approach of Health Canada has been, and will continue to be, one of caution and assurance that First Nations communities feel, and are, ready to take on responsibility for their health programming before transfer occurs.

About the Audit

Objectives

- To determine whether Health Canada manages First Nations health programs in an efficient and effective manner.
- To determine whether an appropriate accountability framework is in place for the transfer of health services to community control.

Scope

The audit covered Health Canada's health programs directed at First Nations, including community health programs delivered through separate contribution agreements, transfer of health programs to community control and Non-Insured Health Benefits (NIHB).

With respect to community health programs delivered to First Nations using separate contribution agreements, we performed a detailed analysis of a sample of agreements involving 40 communities. We reviewed the transfer framework and a sample of 24 transfer agreements. The selection in both cases was made to reflect communities of different regions, sizes and degrees of isolation. We reviewed systems, controls and management practices relating to the delivery of non-insured health benefits and undertook a follow-up of recommendations reported in Chapter 19 of our 1993 Report, on the NIHB program. We carried out extensive interviews with program managers at Medical Services Branch headquarters and selected regional offices and with selected representatives of First Nations communities and professional bodies. In addition, we reviewed program documentation and related health literature.

We did not examine the management of hospitals and other health facilities and environmental health, nor did the audit cover activities in the two territories. We did not audit the integrated agreements because they were developed in 1994 and only a small percentage of First Nations had signed such agreements at the time of our audit.

The quantitative information in this chapter that has been drawn from government sources or departmental databases has been checked for reasonableness but has not been audited.

Criteria

- The community health programs should be designed to facilitate the achievement of objectives in an efficient and effective manner.
- Agreements with First Nations communities for the delivery of community health programs should clearly specify the objectives and activities to be undertaken and the corresponding reporting requirements. There should be monitoring of the implementation of these agreements to ensure compliance and that departmental obligations are met.
- There should be an adequate framework for the transfer of health programs to community control to:
 - ensure that clear health objectives and expected results to be achieved are established;
 - ensure that capacity is aligned with responsibilities;
 - ensure compliance with requirements of the agreements;
 - monitor performance reporting; and
 - report results of transfer in terms of changes to the health of First Nations.
- The Department should have taken action in response to the recommendations contained in the 1993 chapter relating to Non-Insured Health Benefits.
- The Department should have systems, controls and strategies in place to identify, assess and respond to major risk areas in the Non-Insured Health Benefits program.

Audit Team

Christina Brooks
Sylvie Cantin
Gerry Chu
Joanne Moores
Jean Petitclerc

For information, please contact Ronnie Campbell, the responsible auditor.

Chapter 14

Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish

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Fisheries and Oceans Canada — Sustainable Fisheries Framework: Atlantic Groundfish

Assistant Auditor General: Don Young

Responsible Auditor: Doug Timmins

Main Points

14.1 Although many Atlantic fisheries continue to thrive, the 1990s saw the collapse of most of Atlantic Canada's commercial groundfish fishery. As Atlantic groundfish stocks headed toward their lowest levels in recorded history, Fisheries and Oceans Canada and the Northwest Atlantic Fisheries Organization progressively closed most of the commercial Atlantic groundfish fisheries and significantly reduced the total allowable catch for others.

14.2 To address this situation, the federal government implemented income support and adjustment programs to help those dependent on the fishery and also undertook specific initiatives designed to improve fisheries resource management and bring industry capacity into line with the size of the groundfish resource. The government will have spent over \$3 billion of new and reallocated program funds this decade. While some progress has been made, many of the critical problems related to the fishery remain, particularly the excess capacity to catch fish, and the number of people relying on the fishery and associated income support programs remains high.

14.3 Managing the seasonal and labour-intensive Atlantic groundfish fishery on a sustainable basis is extremely challenging. Decision makers face the imprecision inherent in determining the status of fish stocks as well as pressure from fishers, plant workers and industry to maintain access to and income from the fishery, access to employment insurance during the off-season, and access to alternative forms of government support in times of crises.

14.4 Although Fisheries and Oceans Canada has stated principles for a fishery of the future, measurable indicators to assess progress are required. While progress has been made in reducing the number of groundfish licences, excess harvesting capacity in terms of an ability to kill fish remains. The Department needs to further its efforts to identify the extent of the contribution of environmental and other factors to the decline of the groundfish. In addition, fisheries management practices need to be further improved to better manage the risks and uncertainty inherent in managing the fishery as a sustainable resource. A precautionary approach to conservation must be the priority and unsustainable fishing practices need to be addressed.

14.5 The Department has stated that its mandate is conservation of the fishery resource base and that this is implied in current legislation. Nevertheless, we found no clearly stated national policy for sustainable fisheries. In addition, performance indicators need to be further developed and planning and performance reporting processes need to be better integrated.

14.6 The deep cultural attachment to the groundfish fishery has been reinforced by several decades of government subsidies. This has resulted in substantial pressure on government to maintain the status quo; that is, to use the fish as a basis for providing income support. Successive governments have provided increasing income support for the people living in the remote coastal communities in Atlantic Canada. This reaction to social pressures has not resulted in an economically viable fishery. In fact, the absence of the fishery has revealed, more clearly than ever before, the substantial reliance on income support by a significant portion of the Atlantic fishing industry. This reliance makes dealing with already complex problems of overcapacity and fisheries management more difficult.

14.7 With the future of groundfish uncertain, the problems remain critical. In our view, the Department, in conjunction with the government, needs to take further steps to implement the principle that “conservation is the paramount priority”, as well as to continue to pursue efforts to ensure that resource management decisions reflect the principle that “harvesting capacity must match the available resource base.” At the same time, the government must deal with difficult socio-economic decisions about the future of those whom the fishery cannot support, if fisheries management is to ensure an ecologically and economically sustainable fishery.

Introduction

14.8 The 1990s saw the collapse of most of Atlantic Canada's commercial groundfish fishery (Exhibit 14.1). As Atlantic groundfish stocks headed toward their lowest levels in recorded history, Fisheries and Oceans Canada and the Northwest Atlantic Fisheries Organization progressively closed most of the Atlantic commercial groundfisheries and significantly reduced the total allowable catch in others. The majority of these fisheries currently remain closed.

Exhibit 14.1

(This exhibit is not available, see the Report)

14.9 Groundfish, at a harvestable age, are associated with the ocean bottom for the most part. Examples include cod, haddock, pollock, halibut and various flatfish. Groundfish constitute one of the three major Atlantic Canadian commercial catches. The others include shellfish such as shrimp and lobster, and pelagics such as herring and mackerel. While the 1990s saw a decline in groundfish landings, shellfish fisheries experienced significant growth and pelagic fisheries remained stable.

14.10 The decline of groundfish stocks was dramatic. From domestic and foreign annual total catches of 2,000,000 tons in the 1960s, groundfish landings fell to approximately 120,000 tons a year after the collapse. Historically, groundfish had represented two thirds of the entire Atlantic catch tonnage and 40 percent of its landed value. In certain years prior to the collapse, the 600,000 tons of groundfish landed annually by the Canadian fleet had a value of \$350 million and supported over 40,000 fishers and plant workers in hundreds of communities in eastern Canada. They also generated spin-off benefits to other workers in those communities.

14.11 The labour-intensive and predominantly seasonal work provided tens of thousands of Atlantic Canadians income from fishing-related activities and qualified many for unemployment insurance payments during the off-season. Many Atlantic Canadians living in areas without alternative sources of employment faced losing both of those sources of income under progressive moratoria on groundfish, beginning in 1992. Their stark situation contrasted with a smaller number of their neighbours in the more thriving shellfish industry, where high landings and prices fuelled prosperity.

14.12 The social and economic impacts of the moratoria would likely have been much greater had it not been for government intervention through a number of programs. The federal government launched a series of reviews, implemented income support and adjustment programs and undertook initiatives designed to bring the industry's capacity into line with the size of the groundfish resource. In the end, these programs will have cost Canadian taxpayers over \$3 billion during the 1990s. The most recent of these programs, The Atlantic Groundfish Strategy, is providing \$1.9 billion to address income support and adjustment (\$1,748 million), rationalization of capacity (\$97 million) and economic development (\$50 million). The Strategy is a joint program of Human Resources Development Canada, Fisheries and Oceans Canada, the Atlantic Canada Opportunities Agency and the Federal Office of Regional Development - Quebec.

Focus of the audit

14.13 The Office has addressed these issues in a series of three chapters. This chapter sets the stage for the following two chapters on Atlantic groundfish by describing the environment leading up to the groundfish decline and the subsequent response. It provides a synthesis of studies and analyses on how the fishery evolved to a state of commercial moratoria. The chapter also reports on the progress of Fisheries and Oceans Canada toward a sustainable management framework and summarizes the conclusions of all three chapters for the reader.

14.14 Chapter 15 reports on progress of the fisheries management practices in dealing with the fundamental problems of the Atlantic fishery. Both chapters 15 and 16 report on whether income support, capacity

rationalization and adjustment programs administered by Fisheries and Oceans Canada and Human Resources Development Canada have contributed to the achievement of both fisheries management objectives and The Atlantic Groundfish Strategy objectives. Chapter 16 also reports on whether an effective accountability regime for The Atlantic Groundfish Strategy has been established.

14.15 Further details are provided in **About the Audit** at the end of the chapter.

Observations and Recommendations

14.16 One quarter of Canada's Atlantic coast residents live in 1,300 fishing communities, half of which depend entirely on the Atlantic fisheries for their existence. Prior to the groundfish collapse, the Atlantic fisheries accounted for 4.2 percent of employment in Atlantic Canada.

14.17 In 1994, Fisheries and Oceans Canada reported that Atlantic Canada had more than 25,000 registered fishing vessels and about 58,000 registered fishers, about 45,000 of whom were active in the various Atlantic fisheries (Exhibit 14.2). In 1996, Atlantic Canada had 832 federally registered fish processing plants, 741 of which were active.

Exhibit 14.2

(This exhibit is not available, see the Report)

14.18 The groundfish industry has played a significant role in the economies of the four Atlantic provinces and Quebec (Exhibit 14.3). In Newfoundland, for example, the groundfish catch in 1990 represented about 62 percent of the total catch's landed value; historically, the groundfish industry provided about 16 percent of Newfoundland's employment. By comparison, in Nova Scotia, groundfish represented approximately 40 percent of the landed value and about six percent of employment. Quebec and the other Atlantic provinces are involved in the groundfish industry to a more limited extent. In 1997, there were 13,061 groundfish licences in Atlantic Canada. This figure includes 2,626 non-reissuable licences that are planned to be eliminated over time.

Exhibit 14.3

(This exhibit is not available, see the Report)

Collapse of the Atlantic Groundfish Industry

14.19 The current crisis in the health of groundfish stocks throughout Atlantic Canada first emerged in the 1980s and early 1990s. The collapse began with the northern cod stock off the coast of Newfoundland and Labrador — historically, a third of the groundfish catch — and then broadened to most other groundfish species throughout Atlantic Canada.

14.20 The Minister of Fisheries and Oceans closed the northern cod fishery in July 1992. It became clear that key biological indicators were declining rapidly and that the biomass of many groundfish stocks was at the lowest level ever observed. Not only were the stocks declining, but the individual fish were growing more slowly: for example, in four management zones, the weight of individual cod at age seven had decreased significantly between 1977 and 1993. The Fisheries Resource Conservation Council was set up by the Minister of Fisheries and Oceans to provide advice on fishing levels under these conditions. The Council first reviewed the status of groundfish stocks in 1993. It concluded that fishing of many of the groundfish stocks should be stopped to allow them to rebuild.

Impact of the groundfish moratoria

14.21 A substantial amount of processing is required to bring the groundfish product to market; thus, the collapse of the groundfish industry affected not only fishers but an even higher number of people who worked in processing plants.

14.22 Groundfish workers constitute a largely rural and isolated population; the communities where they live offer few alternative sources of employment and rates of unemployment are high. Even if the communities had alternative employment opportunities, many of those involved in the groundfish industry have low levels of education (Exhibit 14.4) and lack experience outside the fishery. Furthermore, many own homes, have strong community ties and strongly believe that the groundfish will return.

Exhibit 14.4

1991 Survey of Atlantic Fishers - Educational Profile (in percentage)

Characteristic	NS		NB		Province PEI		Que.		Nfld.		Atlantic	
	Total	Active	Total	Active	Total	Active	Total	Active	Total	Active	Total	Active
No formal education	1.4	1.1	1.7	0.5	0.9	0.8	1.1	1.4	2.5	2.7	1.8	1.7
Elementary	29.4	30.3	33.6	34.2	25.7	22.8	26.4	23.8	34.9	35.8	31.7	31.8
Some secondary	44.8	45.9	33.1	39.0	46.1	48.0	44.4	47.6	45.6	45.2	43.7	45.1
Completed secondary	15.4	13.5	21.4	15.6	20.8	22.4	20.0	18.7	9.5	9.9	14.8	13.6
Trade/vocational	3.2	3.5	4.9	4.4	1.3	1.1	3.1	3.3	2.9	2.7	3.1	3.0
Some college/completed	2.3	2.4	2.4	2.7	1.5	1.6	3.7	4.2	1.6	1.4	2.1	2.1
Some university/ completed	3.3	3.2	2.8	3.5	3.6	3.4	1.2	0.9	2.9	2.2	3.0	2.7
Total Fishers	16,576	12,767	8,523	5,216	5,702	4,652	5,380	3,467	24,921	19,129	61,102	45,230

Source: Fisheries and Oceans Canada

14.23 Income from unemployment insurance has provided a significant and increasing portion of fisher income over the years. In 1981, for example, for every dollar they earned in the fishery, self-employed fishers received 43 cents in unemployment insurance benefits; by 1990, this had risen to 81 cents. For plant workers, the increase was from 33 cents to 57 cents. (Exhibit 14.5)

Exhibit 14.5

(This exhibit is not available, see the Report)

14.24 The potential impact of the groundfish moratoria was greatest in Newfoundland, the province with the largest groundfish industry. Reliance on unemployment insurance payments was also highest there; by 1990, self-employed fishers were receiving \$1.60 in unemployment insurance benefits for every dollar earned in the fishery, up from 96 cents in 1981.

14.25 The combination of income from the fishery and income from unemployment insurance has proved to be more attractive than other alternatives, whether local or distant, and has allowed many Atlantic coastal communities to maintain their population.

14.26 Without groundfish industry employment, however, many workers have been unable to find enough work to qualify for employment insurance (formerly unemployment insurance). The income support provided by The Atlantic Groundfish Strategy is nearing an end, the fish have not yet returned in sufficient quantity to sustain the industry, and many areas affected by the groundfish collapse still offer few other employment opportunities.

Causes of the Atlantic groundfish decline

14.27 Both fishing and natural causes contribute to total fish mortality. Fisheries and Oceans Canada has identified excessive harvesting as a major factor contributing to the groundfish decline, and has indicated that environmental conditions and predator-prey relations were also contributing factors in certain areas.

14.28 The increase in fish harvesting over time is shown in Exhibit 14.6. This exhibit demonstrates fishing levels much higher than the Department's conservation standard. In many groundfish stocks such as cod, fishing at the conservation standard means catching about 2 out of every 10 fish available in a year, and leaving the remainder to reproduce and support a profitable fishery in future years.

Exhibit 14.6

(This exhibit is not available, see the Report)

14.29 Departmental officials have identified three factors in the overharvesting of groundfish stocks: the fishing levels were set above conservation standards, fishers caught more than they were allocated and certain fishers used unsustainable fishing practices.

14.30 Total fishing levels set above conservation standards. The Minister of Fisheries and Oceans sets out in annual plans the total allowable catch for fish stocks under management, and divides that total among user groups to ensure an orderly and equitable harvest. On occasion, these levels were set higher than the Department's conservation standard for fishing mortality.

14.31 The Department's science function prepares an assessment of the status of groundfish stocks on an annual basis. Prior to 1993, these assessments were subject to peer review by scientists on the Canadian Atlantic Fisheries Scientific Advisory Committee; since 1993, the science function provides these estimates to the Fisheries Resource Conservation Council, which then recommends target fishing levels to the Minister.

14.32 Given the difficulty arising from variability in marine environmental factors and sampling variation, these assessments reflect a lack of precision. It became apparent in 1986 to departmental scientists and external reviewers that a continuing pattern of overestimation of groundfish stocks resulted in a fishing level for northern cod stocks at least double the Department's conservation standard.

14.33 Assessing fish populations is a very challenging endeavour for scientists in Canada as well as other countries. Assessment problems resulted from assumptions in the sequential population analysis prediction model used for many groundfish stocks; these reflected an incomplete understanding of the biology of stocks and suffered from limitations in the data. The Department's science function based its population assessments primarily on data collected from research survey cruises and on commercial fishery landing statistics. There was a time lag between the survey and the period for which assessments were made.

14.34 In the period prior to the groundfish collapse, although the research surveys indicated that some stocks were declining, the data on offshore commercial fishing showed no such decline. Data on commercial fishing operations reflected the results of selective fishing by experienced captains with increasingly sophisticated electronics and gear, in areas of high fish concentrations. In addition, the information on stocks is also inaccurate, due to underreporting, misreporting or additional fishing mortality caused by unsustainable fishing practices, as discussed below.

14.35 The total allowable catch is the total tonnage of a particular fish stock allowed to be caught in a given year. In the years before the groundfish decline, the Minister reviewed scientific recommendations but, by convention, set the total allowable catch under decision rules that provided flexibility. One of these rules provided that the total allowable catch could be halfway between the current fishing mortality level and the target fishing mortality level for the next year. This flexibility served to moderate the socio-economic impact of year-to-year changes in the total allowable catch on a fishing industry with excess capacity; however, it proved to have negative impacts on declining stocks.

14.36 Fishers caught more fish than allocated. Pressure on fish stocks was also due in part to the fishers catching more fish than the amounts allocated to them; for example, haddock landings for 1991 and 1992 were nearly double the total allowable catch. Occasionally, fisheries managers did not close fisheries until some time after the quota had been met, because they did not have available timely data on catches against quotas. Fishing by foreign fleets in the Northwest Atlantic Fishing Organization regulatory area immediately adjacent to the Canadian 200-mile limit was much higher than the Organization's conservation standard (Exhibit 14.7). "The Report on the Task Force on Incomes and Adjustment in the Atlantic Fishery" noted foreign overfishing of straddling stocks as a factor in the decline of cod stocks. Since that time, the Department has been actively advancing international conservation to protect groundfish stocks and reduce foreign overfishing.

Exhibit 14.7

(This exhibit is not available, see the Report)

14.37 Unsustainable fishing practices. According to Fisheries and Oceans Canada, unsustainable fishing practices also contributed to the groundfish collapse. Those practices include unrecorded landings, misrecorded landings, dumping of bycatch and highgrading.

- Unrecorded landings can occur because of the desire of fish harvesters to maximize their return in a competitive fishery and because of limitations and weaknesses in monitoring and recording actual landings.
- Fishers sometimes misrecord landings, reporting fish caught in a closed fishing area as having been caught in an open area.
- Bycatch includes species not targeted by fishers or allowed by single species quotas. For example, fishers might catch halibut as a bycatch in a cod fishery. A certain amount of bycatch is allowed by quotas; excess bycatch is often illegally discarded.
- Highgrading involves discarding fish to make room for more valuable fish that bring a better economic return or for which there is a need at the processing plant. For example, weekly summaries of highgrading by several offshore draggers in the 1980s involved dumping hundreds of tons of fish.

In many kinds of fishing, most of the discards are dead when they are thrown back, or die soon afterward.

14.38 These unsustainable fishing practices have an impact on estimates of fish mortality. Discards and unrecorded landings are generally not reflected in scientists' data on removals by the commercial fishery; misrecorded landings distort the accuracy of stock assessments. The extent of this imprecision is not easily quantifiable, in part due to lack of data.

14.39 Environmental conditions and predator-prey relations. Fisheries and Oceans Canada has indicated that natural mortality may have increased due to predator-prey relations. It emphasized that environmental conditions also contributed to the groundfish collapse in certain areas. This is supported by departmental studies showing the poor physiological condition of the groundfish and other stocks as well as the continued decline of the groundfish stocks after fisheries had been closed. The period of the groundfish decline coincided with Atlantic waters becoming colder. The Department believes that colder waters had a negative impact on groundfish stocks, and has

conducted research on this topic. The period of groundfish decline also saw substantial continued growth in seal populations as the government restricted the fur trade in response to international pressure. Seals consume groundfish as well as capelin, a groundfish food source. The Department has also conducted research on this topic. While ongoing research focusses on partitioning the causes of the collapse of northern cod, there has been no overall departmental statement on the relative extent to which the collapse of groundfish stocks can be attributed to the respective factors.

14.40 Fisheries and Oceans Canada should pursue the identification of the most likely relative contribution of the various factors related to the collapse of groundfish stocks and provide assurance to Parliament that initiatives to deal with this problem address the most probable causes.

Department's response: In recent years, the Department's scientists have undertaken, in collaboration with scientists from various universities, a number of research projects under the Department's Strategic Research Priority Fund to evaluate the relative contribution of various factors in the collapse of groundfish stocks. A scientific workshop to review the results of these projects is planned for March 1998.

Overcapacity — A Fundamental and Long-standing Problem

14.41 The Atlantic groundfish fishery has a history of recurring crises (Exhibit 14.8). Problems with overcapacity, low incomes and low profit levels are long-standing. Until the 1960s, access to Atlantic fisheries was open and there were few limits on catch levels. The fisheries were characterized by excessive investment, low incomes to fishermen, low returns on investment and depleted stocks.

Exhibit 14.8

The Atlantic Groundfish Fishery: A Chronology

1950s and 1960s Post-war expansion	<ul style="list-style-type: none"> • Government policy fosters programs that support development of fisheries • Growing markets for fish in North America • New technology for navigating and fish finding, better engines, bigger boats • Foreign fishing builds up
1967-1969	<ul style="list-style-type: none"> • Weaker markets for groundfish, high inventories, declining prices • Scarcity of some species, catch per unit of effort declining
1970 1970-1973	<ul style="list-style-type: none"> • <i>Economic Policy for the Fisheries</i> intended to maximize employment in commercial fishery • Landings still declining; demand and prices increasing • Landed value increases despite lower landings • International Commission for the Northwest Atlantic Fisheries introduced total allowable catches and national allocations in 1972
1974-1976	<ul style="list-style-type: none"> • Catch rates still declining, unit costs increasing • Oil crisis significantly increases fuel costs • Market prices dropping • <i>Policy for Canada's Commercial Fisheries</i> published in 1976 places people before fish
1977	<ul style="list-style-type: none"> • Canadian fisheries jurisdiction extended to 200 miles • First Canadian Groundfish Fishing Plan allocates stocks among sectors of the fleet
1977-1979	<ul style="list-style-type: none"> • Federal and provincial expenditures in support of fishery increase • Harvesting and processing capacity expands • Entry into virtually all fisheries limited

	<ul style="list-style-type: none"> • Resource shows signs of recovering, market conditions improving but operating losses continue
1981	<ul style="list-style-type: none"> • <i>Policy for Canada's Atlantic Fisheries in the 1980s</i> emphasizes competitiveness, efficiency and extracting more value from resource, rather than expansionist development philosophy of the 1970s
1981-1983 Financial Crisis	<ul style="list-style-type: none"> • High interest rates and high debts related to expansion • High inventories and poor markets, Canadian dollar appreciates, exports uncompetitive
1983-1984 Restructuring the Atlantic Groundfish Industry	<ul style="list-style-type: none"> • Report of the Task Force on the Atlantic Fisheries (Kirby) concluded that the fishing industry had "a grossly inadequate equity base" caused by debt-financed overexpansion after the extension of the 200-mile limit. This led to the restructuring of the major offshore companies • After extensive negotiations with Newfoundland and Nova Scotia, agreement was reached to create two large, integrated companies with an infusion of government and private sector equity
1985-1988 The Glory Years	<ul style="list-style-type: none"> • Groundfish stocks recover from 1977 • Price of cod blocks doubled • More investment in modernizing and rebuilding fleets and plants
1989-1992 Crisis Again	<ul style="list-style-type: none"> • High fishing pressure (well above target levels), catch rates decline • Scientists revise their estimates of northern cod stocks • In March 1990, the Independent Review Panel on Northern Cod (Harris) recommends substantially lower total allowable catch • Large companies experience major losses, close plants and consolidate operations • Atlantic Fisheries Adjustment Program announced in May 1990
1992-1993 Deepening Crisis	<ul style="list-style-type: none"> • In July 1992, Minister announced two-year moratorium on northern cod • Northern Cod Adjustment and Recovery Program (NCARP) to provide income support and support for adjustment out of the fishery • Northern cod stocks continue to decline despite moratorium, other groundfish stocks show signs of collapse • Fisheries Resource Conservation Council provides advice to the Minister on conservation issues, appropriate catch levels • Report of the Task Force on Incomes and Adjustment in the Atlantic Fishery (Cashin) recommends measures to deal with overcapacity, overdependence
1994-1997	<ul style="list-style-type: none"> • In May 1994, The Atlantic Groundfish Strategy replaces Northern Cod Adjustment and Recovery Program and Atlantic Groundfish Adjustment Program to address adjustment and overcapacity • Fishery of the future announced as basis for restructuring the fishing industry in 1996-97 Estimates, Part III; conservation is top priority; capacity rationalization; professionalization, multi-licensing and partnerships

14.42 According to a now-public 1970 Cabinet memorandum, the Canadian fishing industry even then had an overcapacity both in people and equipment. It was overcapitalized by a ratio of more than 2:1, and it was estimated that Canada's commercial catch in 1970 could be harvested by 40 percent of the boats, half as much gear and half the number of fishers.

14.43 At that time, the federal government realized that a deliberate policy of rationalizing the fishery would create challenges, including the relocation of tens of thousands of people, the sale of thousands of vessels and the

phasing out of hundreds of small communities. Because alternative employment was generally unavailable locally, many families would have to be moved and retrained. The government decided that rationalization of the fishery would proceed only as quickly as acceptable alternatives became available. In fact, instead of rationalization the next decade saw expansion.

14.44 The extension of fisheries jurisdiction to 200 miles in January 1977 gave Canada control over the fishery resources off the east and west coasts. Foreign fishing was reduced within the Canadian zone and the allocations available to domestic fleets were increased. Canadian industry reacted by increasing its capacity by investing in larger, more powerful boats with greater technological capabilities. For example, gross registered tonnage increased by 150 percent between 1980 and 1989 (Exhibit 14.9). Competition in the fishery meant that a fisher had to have greater and greater capacity to guarantee a share of the groundfish resource. With larger boats came higher debts.

Exhibit 14.9

(This exhibit is not available, see the Report)

14.45 In the early 1980s, the major firms found themselves in debt and on the verge of collapse, given their rapid expansion of capacity; their debt-to-equity ratio was 9:1. The economic recession, coupled with high interest rates and low prices, caused a financial crisis in the industry. Largely through government intervention, the industry was refinanced and restructured. Overcapitalization and high debts can lead to unsustainable harvesting practices aimed at maximizing the fishers' return on their effort.

14.46 Many people were attracted to the small boat inshore fishery by the easy access granted under past licensing policies and by the lure of government support programs that augmented their limited income from fishing. The period from 1980 to 1991 saw a growth of 31 percent in the number of individuals employed in Atlantic fish processing jobs; during the same period, the available fishery resource declined by 2.5 percent. The discrepancy was particularly notable in Newfoundland, where the number of people in the fish processing sector increased by 50 percent while the available fish stocks declined by 18 percent (Exhibit 14.10). As the resource declined, dependence on the support programs increased; in certain sectors of the fishery there was a total reliance on support because of the complete collapse of the resource.

14.47 The Minister appointed The Scotia-Fundy Groundfish Task Force (Haché) in July 1989, in response to groundfish quota reductions on the Scotian Shelf. The Task Force reported that haddock stocks had been exploited at two to four times the target levels since 1984. The Report concluded that excessive harvesting capacity was a major obstacle to a turnaround in the fishery, and that overcapacity and overinvestment had to be reduced as quickly as possible.

14.48 Given the increasing catch failures in the Atlantic groundfish industry, and other long-standing structural problems of the industry, in 1993 the ministers of Fisheries and Oceans and Human Resources Development established the Task Force on Incomes and Adjustment in the Atlantic Fishery. That Task Force also identified overcapacity as a fundamental problem of the groundfish industry.

14.49 It has been widely recognized that the Atlantic fishery has been estimated to have approximately double the capacity needed. This overcapacity contributes to overfishing because fishermen have substantial investments in vessels and fishing gear, and thus have a desire to maximize their return in a competitive fishing environment.

Socio-economic policies contribute to overcapacity

14.50 Even in more prosperous times, income from the Atlantic fisheries was low. As shown in Exhibit 14.5, net annual earnings from fishing for Atlantic fishers averaged \$8,100 in 1990; with additional work and transfer payments, total average income rose to \$19,300. A fish plant worker earned on average \$8,200 a year from processing; outside work and transfer payments such as unemployment insurance raised total income to \$15,900. Individuals' unemployment insurance benefits on average almost equalled their net earnings from fishing or

processing. In more than half the families involved in the industry, two or more persons made their income through a combination of part-time fishery work and unemployment insurance.

14.51 Unemployment insurance and other initiatives to relieve the socio-economic problems of those in the Atlantic fisheries contributed to overcapacity, since fishery employment even for short periods qualified individuals for unemployment insurance benefits. For example, the period of employment necessary for unemployment insurance varied with the local fishing season; the length of the fishing seasons varied and could be less than 10 weeks.

14.52 Between 1980 and 1991, the number of persons employed in Atlantic fisheries processing increased by a much higher margin than did full-time person-years. This would suggest that by 1991 the average person was working fewer months. The average duration of processing jobs dropped from 8 months in 1980 to 5.5 months in 1991 (Exhibit 14.10).

Exhibit 14.10

Summary of Changes in Fish Processing Employment and Resource Availability - Atlantic Fishery, 1980-1991

	Person-Years			Individuals			% Change in Resource Availability	Average Duration of Fish Processing Job (months)	
	1980	1991	% Change	1980	1991	% Change	1980-1991	1980	1991
Atlantic	31,240	27,939	(11)	46,809	61,515	31	(2.5)	8	5.5
Newfoundland	13,519	10,900	(19)	20,148	30,199	50	(18)	8	4.3
Nova Scotia	10,234	9,836	(4)	12,841	14,627	14	(12)	9.6	8
Prince Edward Island	860	1,481	72	1,690	2,975	76	28	6	6
New Brunswick	4,210	4,174	(1)	7,914	10,064	27	6	6.4	5
Quebec	2,417	1,549	(36)	4,218	3,650	(14)	(13)	6.8	5

Source: Task Force on Incomes and Adjustment in the Atlantic Fishery

14.53 Federal and provincial governments have contributed to capacity by providing loans and loan guarantees to build boats and improve fishing technology. For example, federal support for the fishing industry in Canada included funds provided by the Fishing Vessel Assistance Program (until 1986), the Shipbuilding Industry Assistance Program (until 1985) and the Fishing Vessel Insurance Plan (since privatized). Unemployment insurance payments for fishers increased from \$20.4 million in 1972-73 to \$270.1 million in 1988-89. The Province of Newfoundland provided payments called “bounties” for new inshore fishing vessels. Over the years, the reported number of processing plants with federal registration allowing interprovincial and international sales grew from 641 in 1980 to over 900 in 1988 (Exhibit 14.11), and to 1,063 in 1991; the growth in their number does not capture change in the capacities of individual processing plants.

Exhibit 14.11

(This exhibit is not available, see the Report)

14.54 The above-noted fundamental problems in the groundfish industry demonstrate that:

- groundfish resources are finite;
- the groundfish industry continues to have fundamental overcapacity; and

- even if the groundfish returned to levels seen in the last decade, the groundfish industry could not provide adequate incomes for the number of people historically dependent on it.

14.55 The collapse has provided an opportunity to address these fundamental problems. Without fish, the fishery is no longer a basis for governments to provide income support. The solution requires that the government deal with overcapacity and dependence on the groundfishery.

14.56 The capacity of the groundfish harvesting industry is a term that is not easily defined, and on which there is little agreement. The government has focussed on the number of licence holders or the number of people the industry can employ. While these are important components of harvesting capacity, the risk of overfishing due to the ability and need of the industry to catch fish is also a component. This brings in the concepts of capital investment in technology, major improvements in the ability of improved technologies to catch fish and desired levels of income for those participating in the industry.

14.57 Progress has been made in reducing the number of groundfish licences from over 17,000 in 1993 to just over 10,000 “core” licences in 1997 (Chapter 15, Exhibit 15.5). Nevertheless, excess harvesting capacity in terms of an ability to kill fish remains.

14.58 Fisheries and Oceans Canada should develop and propose a strategy to government to further reduce overcapacity in the groundfish industry.

Department’s response: While significant reduction has been achieved, excess groundfish harvesting capacity remains. Had the budget for rationalization been maintained at \$300 million, a larger number of licences would have been retired under The Atlantic Groundfish Strategy. The Department will propose a strategy to achieve further capacity reduction, over time, taking into account the funding available and the prospects regarding alternative economic opportunities for affected fishers.

14.59 Income support issues must be dealt with in their own right. The resource base is not, and has not been, by itself, sufficient to support the number of people and coastal communities that have depended on the fishery in recent history. It must be recognized that managing the fishery on a sustainable development basis would clearly require finding a solution to the unemployment of people who are no longer part of the fishery. In other words, if the fishery is to be managed on a sustainable development basis, ecologically and economically, then another means of addressing the social and cultural issues of coastal communities has to be found.

14.60 To ensure that the fishery is managed on a sustainable development basis, the government should address the social and cultural issues of coastal communities.

Department’s response: The Department’s objective of conservation is intended to ensure a sustainable fisheries resource that is capable of providing sustainable incomes for harvesters. The Department agrees that the groundfish resource will not be able to provide adequate incomes for the number of people historically dependent on it. Achievement of the Department’s objective for a sustainable fishery would be facilitated by the availability of viable alternatives for affected fishers who can no longer rely upon the fishery for their livelihood.

Federal Government Response to the Groundfish Collapse

14.61 The federal government’s response to the progressive decline of Atlantic Canada’s groundfish stocks included a series of studies, a variety of income support and adjustment programs, fisheries renewal initiatives and changes to fisheries management practices.

Income support and adjustment programs

14.62 Income support and adjustment initiatives to help Atlantic Canada cope with the groundfish decline and collapse have ranged from programs designed to cover localized catch failures in the late 1980s to the larger, more comprehensive programs of the 1990s. These later programs include the Atlantic Fisheries Adjustment Program, the Northern Cod Adjustment and Recovery Program, the Atlantic Groundfish Adjustment Program with its related initiatives and The Atlantic Groundfish Strategy (Exhibit 14.12).

Exhibit 14.12

Groundfish Programs

Program	Atlantic Fisheries Adjustment Program/ Quebec Federal Fisheries Development Program (1990-1995)	The Northern Cod Adjustment and Recovery Program (1992-1994)	The Atlantic Groundfish Adjustment Program and Related Programs (1993-1994)	The Atlantic Groundfish Strategy (1994-1998)
Resources*	\$637 million	\$587 million	\$381 million	\$1.9 billion
Objectives	<ul style="list-style-type: none"> rebuild the fish stocks adjust to current realities economic diversification 	<ul style="list-style-type: none"> respond to the immediate income needs of fishermen and plant workers more economically viable and environmentally sustainable northern cod fishery 	<ul style="list-style-type: none"> enhance employment opportunities upgrade and develop new skills assist those most in need 	<ul style="list-style-type: none"> renew the resource and reduce harvesting and processing capacity facilitate labour adjustment enhance profession of fishers facilitate community economic development
Implementation	Fisheries and Oceans Canada, Employment and Immigration Canada, Labour Canada, Atlantic Canada Opportunities Agency, Federal Office of Regional Development - Quebec, others	Fisheries and Oceans Canada, Employment and Immigration Canada	Fisheries and Oceans Canada, Human Resources Development Canada, Atlantic Canada Opportunities Agency	Fisheries and Oceans Canada, Human Resources Development Canada, Atlantic Canada Opportunities Agency, Federal Office of Regional Development - Quebec
Elements	<ul style="list-style-type: none"> new inputs to stock assessment community-based projects as alternatives to the reduced groundfish fishery direct payments to fishers and plant workers economic assistance 	<ul style="list-style-type: none"> income support assistance to adjust out of the fishery in the form of training, early retirement out of the fishery licence retirement vessel support to assist owners to maintain vessels and gear during the moratorium 	<ul style="list-style-type: none"> income supplement for vessel owners plant worker adjustment vessel support community development fisheries alternative sector partnerships training job development transitional fisheries adjustment fisheries closing training allowance 	<ul style="list-style-type: none"> income support adjustment industry rationalization long-term community economic development

* Main Estimates

14.63 In 1993, the Office of the Auditor General reported on the Northern Cod Adjustment and Recovery Program, which provided income support and adjustment to those affected by the decline of the northern cod between 1992 and 1994. Chapters 15 and 16 of this Report address the implementation of The Atlantic Groundfish Strategy.

Fisheries Management Framework

14.64 The *Constitution Act* (formerly the *British North America Act*) provides for the federal Parliament's jurisdiction over seacoast and inland fisheries. The Act provides the legal basis for the federal government to enact legislation dealing with marine and fisheries services. Fisheries and Oceans Canada carries out the federal government's responsibilities for fisheries management under the *Fisheries Act* and other pieces of legislation.

14.65 One of the challenges in setting up an enduring framework for management of the Canadian fisheries is dealing with jurisdictional responsibility. While the federal government has responsibility for fish harvesting, provincial governments are responsible for registering fish processing plants for operation. The interests of the two levels of government may not always coincide.

14.66 Another challenge is ensuring that there is a common understanding of "a sustainable resource base" and "sustainable development". "A sustainable resource base" involves conservation of the resources for harvesting purposes. "Sustainable development" includes additional considerations such as social and economic impacts.

14.67 Fisheries resources are used for Aboriginal food, social and ceremonial purposes as well as commercial and recreational purposes. Fisheries and Oceans Canada manages many groundfish stocks in Atlantic Canada. In consultation with clients, it sets total allowable catch limits on these stocks for each fishing zone on the basis of scientific advice developed on each stock's individual dynamics. (Stock dynamics include rates of growth, reproduction and mortality.)

14.68 We assessed whether Atlantic groundfish are managed within a framework of management accountability for sustainable fisheries that responds both to the government's objectives and to the Department's mandate and long-term objectives. We found that the fisheries management framework requires clarification. Fisheries management decisions appear to relate directly or indirectly to a number of different federal government policy objectives. The Department has stated that its mandate is conservation, but other related government objectives include providing economic opportunity, facilitating access to reasonable income and Canadianization of the fishery.

National fisheries policy needs to be developed

14.69 It is important that fisheries be managed consistent with a policy of sustaining the fisheries resource base — a policy that would place primary importance on conserving the resource; healthy fisheries would then contribute to achieving and maintaining social and economic objectives, including the viability of coastal communities. Under the Green Plan, the federal government was to develop a national fisheries policy as part of a strategy to ensure the long-term sustainability of fishery resources. Although background papers have been prepared, a national fisheries policy and an action plan have yet to be developed.

14.70 Statements of Canadian commercial fishing policy were advanced in 1970 and 1976. In 1970 the main objective of government fisheries policy was to maximize employment in Canada's commercial fishery. The 1976 Policy of Canada's Commercial Fisheries indicated that in the future fisheries would be regulated in the interest of people. In 1981 the Minister of Fisheries and Oceans published a discussion paper on Canada's Atlantic fisheries policy for the 1980s. This document included as a strategic objective "to maintain fishery resources at levels which will generate the maximum continuing economic and social benefits." The current status of these policy documents is unclear.

14.71 Legislation passed in the 1980s established the objectives of economic viability and maximized employment. The *Atlantic Fisheries Restructuring Act* adopted as a hierarchical set of policy objectives for the Atlantic fisheries:

- that the Atlantic fishing industry be economically viable on an ongoing basis;
- that employment in the Atlantic fishing industry be maximized, subject to the constraint that those employed receive a reasonable income; and
- that fish on the Atlantic Coast of Canada be harvested and processed by Canadians to the extent that this objective is consistent with the first two objectives and with Canada’s international treaty obligations.

While the importance of conservation may have been understood, there was no explicit reference to it in this legislation.

14.72 The *Fisheries Act* provides for regulations to conserve and protect fish. The *Fisheries Act* was amended in 1985 to include a purpose statement providing for the conservation and protection of fish by means of proper management, and for allocation and control of Canada’s seacoast fisheries in order to provide fishers and others with economic and social benefits from the use of fish. However, that purpose statement was repealed in 1987.

14.73 The federal government tabled two new fisheries bills to replace the current *Fisheries Act*, the most recent of which advanced the precautionary approach to fisheries resource management; neither bill became law. The second bill was tabled in 1996 and had not become law when the 1997 federal election was called.

14.74 The recently passed *Oceans Act* specifies that the Minister of Fisheries and Oceans shall lead and facilitate the development and implementation of a national strategy for the management of estuarine, coastal and marine ecosystems in Canadian waters based on the principles of sustainable development, integrated management and the precautionary approach. The legislation defines the precautionary approach as “erring on the side of caution.”

14.75 While the precautionary approach is inherent in the principles of the United Nations Straddling Stocks agreement (Exhibit 14.13), Canada has not yet ratified this agreement or, likewise, the 1982 Law of the Sea Convention. However, Canada was an active participant in the United Nations Conference on the Environment and Development in 1992 in Rio de Janeiro, Brazil, which advanced the precautionary approach. Canadian scientists are working with scientists from other countries to advance the concept of the precautionary approach.

Exhibit 14.13

The 1995 Conference on Straddling Fish Stocks and Highly Migratory Fish Stocks

<p>General Principles</p>	<ul style="list-style-type: none"> • Ensure long-term sustainability, promote optimum utilization • Use best scientific evidence (including environmental) • Assess impacts of fishing on target stocks and non-target species • Maintain populations above “levels at which their reproduction may become seriously threatened” • Minimize pollution, discards, catch by lost gear, catch on non-target species, etc. • Protect biodiversity • Prevent overfishing and excess fishing capacity • Collect and share data on catches and fishing activities • Conduct scientific research and develop technologies for conservation
<p>“Precautionary Approach” to the Management of Fisheries</p>	<ul style="list-style-type: none"> • Protect living marine resources and to preserve the marine environment • Be more cautious when information is uncertain • Improve decision making by sharing best scientific information and adopting ways to deal with risk and uncertainty • Adopt stock-specific reference points • Take into account uncertainties (all types), as well as impact on non-target species • Ensure that reference points are not exceeded - emergency action may be needed

14.76 Fisheries and Oceans Canada should renew its efforts to have the government clarify fisheries objectives in legislation and develop a national fisheries policy framework.

Department's response: The Department agrees that it would be useful to affirm its objectives in legislation and establish a consolidated national policy framework. In this regard, the bill amending the Fisheries Act that was before the House when the election was called described the purpose of the Act as establishing powers, duties and functions to be exercised to conserve and manage fisheries in the interest of the present and future generations. It endorsed the precautionary principle, and affirmed that conservation of Canada's fisheries and their management on a sustainable basis are central to the economic viability of harvesters and processors and the well-being of communities dependent on fisheries resources.

Departmental policy requires clarification

14.77 We found that the Department has set out policy statements in a number of documents; however, there is no integrated, documented sustainable fisheries policy. The Department recognizes this situation and plans to return to Cabinet in the autumn of 1997 to reconfirm its strategy of fishery management reform and to see that the strategy is reflected in a public policy document on fisheries management. The Department is also working on a sustainable development strategy and action plan as required by the recent revisions to the *Auditor General Act*.

14.78 Fisheries and Oceans Canada has developed principles to guide fishing industry restructuring and fisheries management renewal that have evolved over time. The first of these principles places a priority on conservation. However, it is not clear how the priority on conservation relates to other objectives for the Atlantic fisheries currently defined in law: economic viability, employment maximization and Canadianization of the fishery (see paragraph 14.70). It is also unclear how the priority on conservation relates to other considerations that have an impact on sustainable development, such as use of the fishery of the future as a means of accessing income support, assuring the long-term viability of coastal communities and maintaining population in remote parts of Canada.

14.79 Fisheries and Oceans Canada and other stakeholders have made progress with respect to the restructuring principles of professionalization of the fishery, multi-species licences and partnership. However, we were unable to find elaboration on two primary restructuring principles, "conservation is the paramount priority" and "capacity must balance with available resources". For example, what does it mean to say that conservation is the paramount priority? What is capacity? At what point does capacity meet the available fishery resource? And when it does, what becomes of excess fishing and processing capacity?

14.80 Fisheries and Oceans Canada should pursue, as a priority, completion of a consolidated policy framework related to sustaining the fisheries resource base.

Department's response: The Department agrees that a consolidated policy framework would be useful in guiding the implementation of the Department's conservation objective in ensuring the sustainability of the fishery resource. A framework will be prepared to elaborate on the policy objectives and principles that have been adopted by the Department and that are referred to in paragraphs 14.97, 14.98, 15.10, 15.11 and 15.12.

Need to integrate planning and performance reporting

14.81 We reviewed the Department's planning and reporting documents supporting the government's planning, reporting and accountability structure. The Department has been implementing this structure at the same time as it is carrying out severe resource reductions resulting from Program Review, and integrating Coast Guard and fisheries components of the Department.

14.82 We found that performance expectations were not defined precisely enough for Parliament to know when results have been achieved. The indicators of accomplishment provided were frequently actions that the Department intended to take. The Department has not yet developed measurable indicators related to its key guiding principles.

14.83 Fisheries and Oceans has recognized the need to develop performance indicators and an initiative is under way in this regard. Furthermore, for fisheries management, the Department is in the process of developing an approach to business line performance measures related to the conservation of fish stocks, co-management of the fishery and industry capacity.

14.84 The Department uses an accountability accord in fisheries management to set out goals, deliverables, responsibilities and, on occasion, time frames. Progress on this accord between senior management and the Deputy Minister is reported every six months.

14.85 The Department had a fisheries management business plan for 1996-97 that included:

- one business line objective;
- the six priorities of the Minister of Fisheries and Oceans (October 1995);
- seven target areas for fisheries management;
- a subordinate priority or set of priorities within each of the seven target areas (total of 32 subordinate priorities); and
- subordinate targets for each of the priorities within each target area.

14.86 Many of these targets in the fisheries management business plan consisted of actions to be taken; some had delivery dates. The business plan did not identify who was to deliver the expected performance against each target, and periodic reports against targets were not produced. We also found that it was not clear from the business plan how the Minister's primary guiding principles were to be addressed.

14.87 We found limited use of business plans and performance reports at operational levels of the Department. A strategic planning framework has been developed for fisheries management but a strategic plan has yet to be developed.

14.88 The two headquarters organizations most directly involved in national co-ordination of fisheries management activities did not have business plans; such plans could improve the linkage between overall departmental direction and those who implement and enforce management plans for specific fisheries. There is a strategic plan for the national enforcement organization but not for the national fisheries resource management organization.

14.89 **Fisheries and Oceans Canada should establish measurable indicators and performance expectations to assess progress in applying guiding principles and integrate those indicators in its planning, reporting and accountability process that responds to the government model.**

Department's response: The Department agrees and will continue the development of performance measures and business plans in line with government guidelines and standards.

Conclusion

14.90 Managing the Atlantic groundfish industry on a sustainable basis is an extremely challenging goal. Studies of the fisheries' problems have indicated that the majority of people attached to the fishing industry continue to believe that they have a right to fish, or that, should the fishery fail, they are entitled to income support. Because fishing incomes are generally low and seasonal, fishers have regularly relied on employment insurance benefits to provide additional income.

14.91 The problems in the fishery are very complex and the common property nature of the resource adds to this complexity. It is not just a case of managing the resource with consideration of ecological and economic sustainability; it also involves considering the social and cultural implications of these decisions. While key groundfish resource allocation and related management decisions are the legislative responsibility of the Minister of Fisheries and Oceans, a solution to the fundamental problems of the fishery involves several departments of the federal government and, indeed, other governments and external parties. Thus, fisheries resource allocation and management decisions have a political dimension.

14.92 Currently, the incentive is for fishers to remain attached to the fishery rather than to leave it. In fact, those involved in the industry may see an advantage to strengthening the attachment where possible, since federal income support or employment insurance benefits remain attractive compared with other social support programs, and few employment alternatives exist. It appears that provincial governments and other organizations may have little reason to encourage people to leave the fishery; in the absence of employment alternatives, the demand on provincial social programs could increase.

14.93 As we have noted in this chapter, a national fisheries policy is lacking. Principles have been stated, but measurable indicators to guide and assess progress need to be developed. The Department needs to integrate these principles in its planning and performance reporting processes. As Chapter 15 points out, while progress has been made toward achieving the principle of matching capacity to the resource base, much more effort is required to reduce harvesting capacity.

14.94 We also note that high numbers of people still rely on the fishery and on associated income support. In the past, this created a demand that could not be sustained by the capacity of the resource base and there is no reason to expect that this will change in the future. The movement of funding for The Atlantic Groundfish Strategy from the adjustment and rationalization components of the program to the income support component served to encourage people to remain attached to the fishery and dependent on federal government support. The original objective of a 50 percent reduction in capacity established under The Atlantic Groundfish Strategy will certainly not be achieved by the anticipated end of the Strategy in 1998.

14.95 After spending over \$3 billion of new and reallocated funds to support the industry, including \$1.9 billion under The Atlantic Groundfish Strategy, the problems in the groundfish fishery remain. The fisheries management practices need to be further improved to ensure the sustainability of the resource base; dependency continues on the fishery to provide access to federal income support programs; and few employment alternatives exist for people in coastal communities. The problem is compounded by the fact that the majority of the people in these communities have education levels that limit alternative choices of employment.

14.96 In summary, our main audit findings are:

- a national fisheries policy has not yet been put in place;
- further progress is required in dealing with the fundamental problems in the fishery, especially matching capacity to the resource base (see Chapter 15);

- an adequate accountability framework was not established for The Atlantic Groundfish Strategy (see Chapter 16); and
- income support, adjustment and rationalization of capacity provided by programs have not contributed significantly to fisheries objectives or to those of The Atlantic Groundfish Strategy (see Chapters 15 and 16).

The reduced funding provided for labour adjustment and rationalization of capacity resulted in failure to achieve the fisheries objectives of The Atlantic Groundfish Strategy.

14.97 We believe that the government needs to deal with overcapacity. However, we recognize that while the Minister of Fisheries and Oceans has the power to reduce capacity and conserve fish, and the Department has taken a number of initiatives, the Minister and Department cannot solve the sustainable development problem associated with the fishery by themselves. The resource base is not, and has not been, by itself, sufficient to support the number of people and coastal communities that have depended on the fishery in recent decades. It must be recognized that managing the fishery on a sustainable development basis would clearly demonstrate the need to find a solution to the unemployment of people who are no longer part of the fishery. In other words, if the fishery is to be managed on a sustainable development basis, in an ecological and economical manner that reflects stated intentions, then another means of addressing the social and cultural issues of coastal communities has to be found.

14.98 This concern requires urgent attention. It is reasonable to expect that there will be pressure for further income support after the end of funding under The Atlantic Groundfish Strategy, since overcapacity remains and there is little indication that the fish are returning in sufficient numbers to allow the levels of fishing that existed before the moratoria. Even if the groundfish stocks were to return to historical levels, dependency on government income support would continue in some form unless there were to be a substantial reduction of participation in the fishery. The level of income the fishery can provide is limited.

14.99 We are concerned that if further funding is provided primarily for income support, the excess capacity in the industry will still not be addressed. The previous programs have not worked, and there is no reason to believe that this approach will be any more successful if applied again in the future. The impact of not addressing the well-documented fundamental problems of the fishery has been clearly demonstrated in the Atlantic groundfish industry.

About the Audit

Scope

Chapter 14 sets out the historic, biological, economic and social context in which the Fisheries and Oceans Canada manages groundfish resources, reviews identified causes of the current crisis and examines the federal government response. The chapter describes the roles of Fisheries and Oceans Canada and Human Resources Development Canada in The Atlantic Groundfish Strategy. It also examines whether the principles of the fishery of the future as advanced by Fisheries and Oceans Canada provide a sustainable management framework as they apply to the groundfish industry.

Chapter 15 reports on the implementation of these principles, steps taken to match fishing capacity to the fishery resource and progress toward establishing partnerships with industry. It assesses the extent to which changes to fisheries management practices deal with the fundamental problems in the fishery.

Chapter 16 assesses the degree to which the adjustment components of The Atlantic Groundfish Strategy administered by Human Resources Development Canada and Fisheries and Oceans Canada have adjusted fishers and processors out of the groundfish industry.

Objectives

We carried out our audit to determine:

- whether Atlantic groundfish fisheries are managed within a sustainable framework (Chapter 14);
- whether fisheries management practices for the Atlantic groundfish fishery have resulted in progress in dealing with the fundamental problems in the fishery (Chapter 15);
- whether an effective accountability framework for The Atlantic Groundfish Strategy has been established (Chapter 16); and
- the extent to which the income support, capacity rationalization and adjustment programs administered by Human Resources Development Canada and Fisheries and Oceans Canada have contributed to the achievement of fisheries management objectives and The Atlantic Groundfish Strategy objectives (Chapters 15 and 16).

Criteria (Chapter 14)

We would expect that the Atlantic groundfish management framework and the framework for The Atlantic Groundfish Strategy would adequately respond to government policy objectives as well as the Fisheries and Oceans mandate and long-term objectives.

We would expect that appropriate implementation strategies and performance expectations for groundfish fishery management objectives would be developed based on adequate information and analysis, to deal with the fundamental problems of the fishery.

We would expect that Fisheries and Oceans would periodically report on the extent to which fisheries management objectives and The Atlantic Groundfish Strategy objectives have been achieved.

Criteria for Chapters 15 and 16 are found in those chapters.

Audit Team

Glenn Doucette
Kathleen Hobbs
Kevin Potter
Michael Ryan

For information, please contact Doug Timmins, the responsible auditor.

Chapter 15

Fisheries and Oceans Canada — Rationalization and Renewal: Atlantic Groundfish

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Fisheries and Oceans Canada — Rationalization and Renewal : Atlantic Groundfish

Assistant Auditor General: Don Young

Responsible Auditor: Doug Timmins

Main Points

15.1 The Department has identified the need for fundamental changes in the fishery, in its relationship with the industry and in its management practices, in order to achieve a sustainable fishery. Since 1992, the Department has moved to reduce the number of groundfish licences, made changes in the management of the fishery and is developing new arrangements for the sharing of responsibility for managing the fishery in the future.

15.2 A key objective of The Atlantic Groundfish Strategy (TAGS) and other initiatives is to reduce existing harvesting capacity by at least 50 percent over the long term. The allocation of funds to reduce harvesting capacity under TAGS, originally \$300 million, was subsequently reduced to \$97 million. The Department focussed its capacity reduction efforts on the removal of licences and is paying about \$88 million of this amount to fishers to retire 545 groundfish licences and 266 fishers without licences. The Department would have been able to reduce more licences had the funds allocated to licence buyback and retirement not been reduced by almost \$200 million. A further 2,626 licences have been identified for eventual removal from the fishery once the current licence holders exit the fishery. Assuming that the Department is able to effect the removal of these licences, it will have removed approximately 23 percent of the groundfish licences in place at the time TAGS was introduced. However, this will still leave about 10,000 groundfish licences, a portion of which represents the groundfish harvesters who historically caught most of the fish. Thus, significant overcapacity, in terms of the ability to catch fish, will remain.

15.3 The Department has made many changes to its groundfish management activities since 1992, which it believes represent improvements over practices that were previously in place. These changes include the introduction of conservation measures in conservation harvesting plans and the integration of fisher knowledge in groundfish management. Nonetheless, fisheries management practices need to be further improved to ensure the sustainability of the resource base.

15.4 Past management practices were introduced with the intention of ensuring conservation. For a variety of reasons, these practices were not successful when implemented. To deal with the inherent uncertainty of the resource base, a precautionary approach is required as a basis for decisions. In addition, further improvements are necessary in catch monitoring, and enforcement must become a more important and active component of groundfish management.

15.5 While implementing Program Review cutbacks, the Department is also reorganizing. Its long-term strategy is to transfer more fisheries management responsibilities to the groundfish industry. The transfer has not yet occurred, in part because of legislative limitations but also due to the inability of some segments of the industry to accept greater responsibility. In the absence of assurance that industry can and will accept increased responsibility, we are concerned about the potential impacts on conservation as a result of reductions and planned changes to the Department's groundfish management activities.

Introduction

Crises are not new to the groundfish industry

15.6 The Atlantic groundfish industry has a history of critical problems, some of them social and economic. In the 1990s, the collapse of the stocks added to the existing social and economic factors, heightening the crisis.

15.7 Chapter 14 sets out the historic, biological, economic and social context in which the Department manages groundfish resources. It reviews some causes of the current crisis, describes the federal government's response, and thereby establishes a context that is important to a complete understanding of the issues raised in this chapter. Chapter 16 focusses on The Atlantic Groundfish Strategy (TAGS) and examines the labour adjustment component, for which Human Resources Development Canada is responsible, and the accountability framework of the Strategy.

Government initiatives to rationalize the industry and renew fisheries management

15.8 Fisheries management has been under great stress since the groundfish stocks began to decline in the late 1980s. By 1993, the full extent of the decline had become clear to the government.

15.9 In April 1994, the government established The Atlantic Groundfish Strategy as a response to the groundfish crisis. The Strategy provided for income support to fishers and plantworkers affected by the collapse of the groundfish stocks, as well as adjustment to employment outside of the fishery, reduction of industry capacity and renewal of the industry.

15.10 The 1994 Program Review exercise required government departments to rethink the rationale for all of their programs. As part of that exercise, Fisheries and Oceans Canada identified its core mandate as "the conservation and sustained utilization of fisheries resources in marine and inland waters."

15.11 The Department established a strategic action plan as a result of Program Review, covering all Atlantic fisheries, for implementing industry rationalization and fisheries renewal initiatives. An important factor in developing the strategy was the reduction in resources allocated to fisheries management (including the science function), which the Department has reported will decline by approximately 40 percent by 1999. The strategy for fisheries management focussed on three areas:

- emphasis on the primary mandate, conservation and sustained use of the resource, and withdrawal from activities less relevant to this core business (such as industry support and small craft harbours);
- simplified and more effective program delivery; and
- devolution to fish harvesters of a greater decision-making role and more responsibility for costs of resource conservation and management.

15.12 The plan emphasized industry restructuring (changing the fishery and the Department's relationship with the industry) and fisheries management reform (changing the way the Department manages the fishery). The objective was to achieve a fishery that is:

- economically and environmentally sustainable;
- stable and capable of providing adequate levels of income; and

- self-reliant, competitive and viable without subsidization.

The Department recognized that the move to this vision of the fishery of the future would take a longer period of time to institute for the groundfish industry than for other Atlantic fisheries.

Current status of the groundfish stocks

15.13 The number of groundfish stocks that were available for commercial fishing during the 1996 fishing season was very limited. The only significant fishing was off southwest Nova Scotia for cod, haddock, flounder and pollock. In other areas, there was fishing for flounder, redfish and Greenland halibut. The total allowable catch or quota for these fisheries represents only a small percentage of the fishery that existed prior to the moratoria.

15.14 During this audit, the Minister announced that fisheries would be reopened for cod stocks within Northwest Atlantic Fisheries Organization (NAFO) fishing zones off Newfoundland — 3Ps (the south coast) and 3Pn4RS (the northern Gulf of St. Lawrence). These fisheries were reopened at levels below the historical catch rates prior to the moratoria. Groundfish moratoria are still in place for 20 groundfish stocks across Atlantic Canada.

Focus of the audit

15.15 This chapter reports on fisheries management practices for the Atlantic groundfish fishery and the extent to which they have resulted in progress in dealing with historical fundamental problems in the fishery. It also describes the extent to which the capacity rationalization administered by the Department has contributed to the success of both fisheries management and The Atlantic Groundfish Strategy objectives. Details of the historical fundamental problems in the fishery are identified in Chapter 14, and can be summarized as:

- overcapacity in the harvesting and processing sectors;
- the difficulties in accurately assessing the status of the groundfish stocks on a timely basis, arising from variability in marine environmental factors and sampling variation; and
- fishing at levels that are not sustainable, including the use of unsustainable fishing practices (misreporting, dumping of bycatch, highgrading, etc.).

The processing sector is the responsibility of the provincial governments and therefore was not directly covered by this audit. Overcapacity in the processing sector puts pressure on the federal government to ensure that sufficient fish are available to operate the plants. The management of groundfish stocks that are within the NAFO jurisdiction was not covered by this audit.

15.16 We examined selected key initiatives that the Department has taken to address these problems. In particular, we audited the capacity reduction initiatives designed to reduce excess harvesting capacity; the information-gathering initiatives designed to improve the assessment and management of stocks; enforcement initiatives designed to address unsustainable fishing practices; and initiatives designed to provide more control and responsibility to fishers. There are some government initiatives that could have an impact on the rationalization and renewal of the Atlantic groundfish industry but that were not within the scope of this audit, although they may be referred to in the chapter. Exhibit 15.1 displays rationalization and renewal initiatives, highlighting those that were included in the audit. With the exception of the TAGS programs, these initiatives apply to more than just the groundfish industry.

Exhibit 15.1

Initiatives toward the Rationalization and Renewal of the Fishery

Industry Rationalization	Fisheries Management Renewal
TAGS - Groundfish licence retirement program TAGS - Early retirement program Atlantic licence review Professionalization The new <i>Fisheries Act</i> <ul style="list-style-type: none">• Partnerships or co-management• Sanctions	The new <i>Fisheries Act</i> <ul style="list-style-type: none">• Partnerships or co-management• Sanctions Science-based, precautionary approach Integrated fisheries management plans Conservation harvesting plans Enhanced catch monitoring Effective enforcement and compliance
Unemployment Insurance reform Access fee increases	Access fee increases Multi-departmental integrated registration and reporting

Note: Shading indicates initiatives included in the audit.

15.17 Further details are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

Industry Rationalization

Previous attempts to reduce capacity

15.18 The collapse of the northern cod stock, which led to the moratorium in 1992, focussed the government's attention on the problem of overcapacity in the fishery. As part of the Northern Cod Adjustment and Recovery Program (NCARP), the government set out to reduce the capacity in the groundfish harvesting sector through removal of groundfish licences. It was able to retire 876 groundfish licences at a cost of \$24.8 million, but recognized that overcapacity still existed. Chapter 15 of our 1993 Report noted that the Department had achieved lower than expected reductions in the number of licence holders.

15.19 In 1992, the Minister "froze" 5,346 inactive groundfish licences. After appeals and the review of The Atlantic Groundfish Strategy Special Eligibility Criteria, 1,981 groundfish licences were eventually eliminated.

The Atlantic Groundfish Strategy continues response to groundfish crisis

15.20 Subsequent to 1992, the crisis in the groundfish fishery spread beyond northern cod to almost all of the other groundfish stocks. The government responded to this growing crisis with the announcement of The Atlantic Groundfish Strategy (TAGS) on 14 April 1994. TAGS was a multi-departmental strategy to provide income support to fishers and plantworkers affected by the collapse of the groundfish stocks, as well as adjustment to employment outside of the fishery, reduction of industry capacity and renewal of the industry. Exhibit 15.2 sets out the initial and final funding levels for each of the TAGS program elements.

15.21 The capacity reduction element, the responsibility of Fisheries and Oceans Canada, was approved in principle based on the number of groundfish licences being identified as the main factor in the overcapacity of the

industry. In its initial approval of the program, the government indicated that a reduction of at least 50 percent was required. This reduction was to be accomplished through the buyback of licences and the provision of early retirement annuities for fishers, and the identification of a professional “core” group of fishers that would participate in the fishery when stocks had recovered; it was to be complemented by unemployment insurance reform. The licence buyback and early retirement programs would target those fishers that were to be included in the “core” group.

15.22 In December 1994, the government set criteria that limited the target population for licence buyback and early retirement to only full-time groundfish licence holders who had an annual fishing income of at least \$3,000 and for whom fishing represented 75 percent of earned income. In addition, they had to be full-time fishers with seven years’ experience. These criteria, called the Special Eligibility Criteria, set the target population for these programs at 6,200 licences, with a target of 2,000 licences to be retired by the licence buyback program.

15.23 When it became apparent that the level of funding set aside for TAGS income support was not going to be sufficient for the number of eligible individuals, the government reprofiled funds from capacity reduction to income support. See Exhibit 15.2 for an explanation of these and other reductions in funding for capacity reduction initiatives. For more detailed information on the problems associated with the funding for TAGS, refer to Chapter 16.

Exhibit 15.2

Changes in the Funding Approved for Components of The Atlantic Groundfish Strategy

	Funding (\$ millions)	
	April 1994	March 1997
Human Resources Development Canada	1,550	1,748 *
Fisheries and Oceans Canada	300	97 **
Economic Development	50	50
TOTAL	1,900	1,895 ***
* See Exhibit 16.6 for details of funding changes for income support and labour adjustment		
** Details of Fisheries and Oceans Canada		
Projected Expenditures	(\$ millions)	
Groundfish Licence Retirement Program	59.7	
Early Retirement Program	28.5	
Operating Costs	8.3	
TOTAL	96.5	
*** 5.2 million was transferred to NCARP - Plant Workers Adjustment Program		

Source: Fisheries and Oceans Canada

15.24 Identifying the “core” fishers. As noted earlier, TAGS capacity reduction included an initiative to identify a professional “core” group of fishers who would remain in the fishery when stocks had recovered. The initial identification of “core” licence holders was to have been completed by 30 June 1994. Originally, the criteria for establishing who would be allowed to continue in the fishery were to be the same as those used in the TAGS capacity reduction exercise (namely the Special Eligibility Criteria). In December 1994, this exercise identified about 6,200 groundfish licences to be included in the “core” group and about 7,800 to be excluded.

15.25 There was an industry concern that the Special Eligibility Criteria were not appropriate for every Atlantic region, and that the Department should not impose any single set of criteria across all Atlantic fisheries. On 12 May 1995, the Minister announced that the Department would undertake a review of the licensing policy, including public consultation. The objective of the review was to promote multi-species licences and a “core” cadre of professional full-time fishers.

15.26 After consultation with the industry, the Department established four broad guidelines to be used in developing regionally based criteria. Fishers who would remain in the fishery would have to:

- be the head of an enterprise;
- hold key licences (lobster, crab, active groundfish, etc.);
- have an attachment to the fishery; and
- be dependent on the fishery.

Fishers who did not meet these guidelines would not be removed from the fishery, but their licences would be cancelled once they exited the fishery.

15.27 Criteria were developed in each of the Department’s regions through consultation with industry to determine which fishers would be included under the new licensing policy. In December 1995, the regional criteria were applied to the active groundfish licence holders in Atlantic Canada and Quebec (about 13,600). This process identified approximately 9,800 fishers to be included under the new licensing policy, while the remaining 3,800 fishers would remain in the fishery with limits placed on their ability to transfer their groundfish licences. The Department sent letters to the fishers who were excluded to explain the reasons and to inform them that they had the right to appeal the decision.

15.28 Subsequently, public protests by a segment of the groundfish industry raised concerns about the licence reform process. The Minister and departmental officials met with the fishers and considered their concerns. On 8 March 1996, after a number of meetings with the fisher groups and their representatives, the Minister announced that some of the criteria would be modified.

15.29 These changes resulted in an increase in the number of fishers included under the new licensing policy. As of December 1996, there were 10,435 groundfish licence holders included in the “core” and 2,626 excluded. See Exhibit 15.3 for a summary of the targets for fishers to be excluded from the “core”, and the final results.

Exhibit 15.3

(This exhibit is not available, see the Report)

15.30 The results of the Atlantic licence review are lower than the initial target and will not be fully felt in the groundfish industry until some time in the future. The changes to the licensing policy effectively put a cap on the number of groundfish licences in the future. Nonetheless, the fishers who will remain in the fishery have historically accounted for a significant portion of the Atlantic groundfish harvested.

15.31 Licence buyback element. The licence buyback element, eventually called the Groundfish Licence Retirement Program (GLRP), was to be administered by a federal–provincial board that would manage programs to reduce capacity in both the harvesting and processing sectors. Except for the Province of Newfoundland, the federal government was not able to get provincial participation. In October 1994, the federal government established four harvesting adjustment boards to carry out the licence buyback program. The harvesting adjustment boards were to operate independently of government. The boards were responsible for developing capacity reduction plans and providing advice and recommendations to the Department on eligibility issues. The boards were to make recommendations to the Department on the licences that should be retired. In December 1994, the government established terms and conditions for the program and the Minister began the process of accepting bids for the GLRP on 31 January 1995.

15.32 The harvesting adjustment boards developed capacity reduction plans that suggested setting \$500,000 as the maximum amount to be paid to an individual licence holder. It was believed that this would remove the most harvesting capacity for the dollars expended. In August 1995, the capacity reduction plans were modified by the Treasury Board to reduce the maximum acceptable bid levels to \$350,000 for vessels over 35 feet and \$180,000 for vessels under 35 feet; vessels over 100 feet were excluded. The Treasury Board also required that 75 percent of the bids accepted be from licence holders with vessels under 35 feet. This was done so that all sectors would be affected in proportion to their historical share of the fishery.

15.33 The GLRP was conducted through a reverse auction bidding process (the lowest ratio of bid amount to groundfish landings wins). Two rounds of bidding were conducted; the first round of approved buyouts was announced in October 1995 and the second round in August 1996. In total, the GLRP retired 478 licences at a cost of \$59.7 million. The GLRP effectively had to “buy down” a future stream of guaranteed TAGS benefits. Approximately 38 percent of the cost of licences retired represented the cancellation of future TAGS benefits. With no more funding available and the program completed, the harvesting adjustment boards were dissolved except in Newfoundland, where that board continued to work jointly with the Province on these and other issues. The harvesting adjustment boards were not able to achieve the targets initially set for them due in large part to the reductions in program funding. The Treasury Board modifications to the maximum bid amount and the historical share condition reduced the probability that vessels with historically higher landings would be removed from the industry. Exhibit 15.4 shows the estimated impact of the Groundfish Licence Retirement Program in terms of value of landings and number of groundfish licences retired.

Exhibit 15.4

(This exhibit is not available, see the Report)

15.34 Early retirement element. The early retirement element did not achieve the level of participation initially expected. It retired 333 fishers at a projected cost of \$28.5 million; of these, 67 fishers also held groundfish licences. The results of the early retirement element were largely affected by other aspects of TAGS. For example, fishers could remain on TAGS income support and receive financial support similar to that provided by early retirement while still retaining their groundfish licences.

Overcapacity remains

15.35 Exhibit 15.5 shows that the number of groundfish licences declined from 17,193 in 1993 to 13,061 in 1997, of which 10,435 represents the “core” group of fishers. However, a portion of this “core” group of fishers are the groundfish harvesters who historically caught most of the fish. Significant overcapacity still remains. Chapter 14 provides an historical perspective of the harvesting capacity problems associated with Atlantic groundfish.

Exhibit 15.5

Changes in Groundfish Licences 1993 to 1997

Licences 1993	17,193
“Frozen” inactive licences	(1,981)
Retired under NCARP	(876)
Attrition	(314)
Licences 1994	14,022
Licence buyback	(478)
Early retirement	(67)
Attrition 1994 to 1996	(416)
Licences 1997	13,061
Atlantic licence review - non-core licences	(2,626)
“Core” Licences 1997	10,435

Source: Fisheries and Oceans Canada

Other capacity reduction considerations

15.36 Harvesting capacity reduction without direct government intervention has been achieved in the offshore groundfish sector, a sector that historically represented approximately 40 to 50 percent of the catch. The companies in this sector are managed under a quasi rights-based system called Enterprise Allocation (they are granted a right to a specific share of the quota and the right to sell or transfer this to others). When the Enterprise Allocation system became permanent in 1988, the number of vessels in the offshore sector was greatly reduced. The decline of the groundfish stocks in the 1990s brought about further substantial reductions. The companies continue to retain their proportional share of the quota should fishing resume. An exception is the northern cod fishery, where the Minister has indicated that the offshore sector will not be allowed to fish until the inshore sector has returned to its historical catch levels.

15.37 The inshore sectors also have licence holders that participate in quasi rights-based management systems, referred to as Individual Transferable Quotas (ITQ). Contrary to the offshore sector, these licence holders were eligible for the licence buyback program and 39 ITQ licences were bought under that program. The Department is holding the quota it bought pending a final decision on disposition (in at least one instance, the Department bought back quota but continues to permit it to be fished to fund research surveys by the ITQ fleet). Rights-based management systems are designed to allow industry rather than government to match the capacity with the available resource (a self-rationalizing system with no cost to government). In this case, the inclusion of ITQ licences in the buyback program provided a consistent approach with the remaining inshore licence holders. However, it did not permit the self-rationalizing rights-based approach to take effect.

Transfer of management responsibility to industry

15.38 As a result of the Program Review process, the Department established a strategic action plan that set out certain key intentions, including the move toward sharing fisheries management responsibilities with industry. The *Fisheries Act* establishes the responsibilities of the Minister and the Department for the management of Canadian fisheries, which places certain limitations on the devolution of fisheries management responsibilities to the industry.

15.39 On 3 October 1996, the government introduced new legislation that, among other things, proposed the establishment of fisheries management partnering agreements. This would allow the Department and any fishers' representative organization to enter into agreements on:

- harvesting limits;

- conservation and management measures for a fishery;
- the development of sanction guidelines;
- the number of licences to be issued; and
- the funding arrangement for management of the fishery.

The Department would maintain responsibility for the assessment of groundfish stock status, setting overall resource harvesting levels, and managing intersectoral and interregional allocation and enforcement.

15.40 The proposed legislation died on the order paper when the House of Commons prorogued on 27 April 1997. The Department has continued to move toward increased industry involvement in fisheries management. Within the limitations imposed by the existing *Fisheries Act*, fishers and their representative organizations are increasingly involved in gathering scientific knowledge, developing conservation harvesting plans and monitoring catches. The Department, in collaboration with industry, is working on a Code of Conduct for Responsible Fishing to promote conservation-based harvesting.

15.41 In the Maritime region, community management boards have been established that set out specific harvesting measures (such as limits on the amount of fish that can be landed in a period of time, the means of sharing the resource among the participants and penalties for non-adherence) for the vessels operating in that community group. The responsibility for control of the conservation risks associated with these local fishing plans rests with the community management boards. Some of the measures included in the local fishing plans were previously considered by the Department to have had negative impacts on conservation. For example, the Department discontinued the use of individual trip limits in the early 1990s as it found that fishers tended to dump unfavourable species and small fish when subject to these controls. In this instance, the Department has indicated that trip limits are an interim measure that it believes will eventually lead to more effective conservation measures.

15.42 The Department is reorganizing and reducing its overall fisheries management activities (for example, at-sea observers, science and enforcement) in anticipation of increased fisher responsibility. It has indicated that its resources are scheduled to be reduced by 40 percent by 1999. There are potential risks to conservation should major changes to fisheries management occur prior to the industry's accepting responsibility.

15.43 **The Department should ensure that accountability for the conservation and protection of the groundfish stocks is an integral part of any arrangements with industry to take on increased fisheries management responsibilities.**

Department's response: The Department agrees that conservation must remain the primary objective and must not be compromised. This requirement is integral to all co-operative arrangements with harvesters, such as co-management agreements, preparation of conservation harvesting plans, and integrated fisheries management plans. Achieving a sustainable fishing industry through conservation-based harvesting needs to involve co-operative action with harvesters.

Fisheries Management Renewal

Common approaches exist in groundfish management

15.44 The strategy adopted by the Department for fisheries management renewal has implications for the way it conducts its business and the way it relates to the fishing industry. Since the collapse of the groundfish stocks, the Department has made changes to certain of its key groundfish management activities.

15.45 The management of Atlantic groundfish stocks varies somewhat from stock to stock and from region to region, but there are some common characteristics. For instance, most of the stocks, certainly all of the significant stocks, are managed under a system of control over both quota and effort (for example, gear types and time allowed on the water). A quota is established for the weight of fish that can be harvested in a particular year. This quota is then allocated to various fisher groups based on their historical share of that fishery or on some other basis as determined by the Minister. An overview of the current groundfish management cycle is shown in Exhibit 15.6.

Exhibit 15.6

(This exhibit is not available, see the Report)

Knowledge-gathering processes need to be improved

15.46 The Department and industry support the gathering of knowledge about the marine environment and related fisheries so that they can better understand the biology of various groundfish stocks and, therefore, make informed decisions for the sustained use of the resource. All of these knowledge-gathering processes are designed to provide support to the Minister in the conduct of his legislative responsibilities under the *Fisheries Act*, including decisions about stock use.

15.47 It should be recognized that the Minister can never be provided with information on the groundfish stocks that is 100 percent precise. The stock assessment process is intended to gather the information necessary to minimize the risk inherent in the decisions made by the Minister on the use of stocks.

15.48 Canadian fisheries managers and scientists are knowledgeable and experienced, as evidenced by their representation on, and significant contribution to, many international organizations dealing with fisheries. Yet the collapse of the groundfish stocks has provided ample evidence that there is still a great deal that must be learned by fisheries scientists and managers in Canada. Exhibit 15.7 sets out some of the past problems that the Department itself has identified in the knowledge-gathering processes. Canada is not unique in having to deal with these problems.

Exhibit 15.7

Past Problems Identified in the Gathering of Knowledge about Groundfish Stocks

- The quality of data provided by fishers to the Department on commercial fishery catch and effort has been poor. The Department and industry have recognized that the figures are understated and inaccurate. This information is an essential component of the stock assessment process.
- Since 1986, the Department has recognized that the model used to determine the status of most of the key groundfish stocks has consistently overstated their abundance and understated the level of mortality.
- The model incorporates the assumption that natural mortality is constant in nature while the fish stocks and their environment are continually changing. In many instances, the Department did not have the information that accurately reflected the current status of the stock.
- There were significant time lags between the research surveys and supporting scientific analysis and the final delivery of the stock status assessment and related advice to the Minister. There were further delays caused by the resource management planning process in place at that time. This meant that decisions on stock use did not necessarily reflect the current status of the stock.

15.49 Stock assessments conducted by the Department rely on the completeness and accuracy of the information on catch and effort provided by industry and maintained by fisheries management, the level of understanding of the biology of the stocks under study and the quality of the research surveys. We have observed that problems still exist in the processes used to collect information used in the stock assessments.

15.50 Fisheries scientists have informed us that there are still problems with the assumptions used in the models that are difficult to remedy. For example, fisheries scientists may never be able to get ongoing current information about such things as the percentage of a stock mortality due to natural causes; therefore, the level of natural

mortality is assumed to be constant at about 18 percent for most stocks. Also, no allowance is made for unsustainable fishing practices because the Department has not estimated the impact of such practices for stock assessment purposes. Instead, it assumes that the level of unsustainable fishing practices remains constant from year to year. The absence of support for these assumptions adds to the uncertainty involved in the stock assessment process and, historically, it is the imprecise nature of the stock assessments that has permitted industry to pressure ministers for access to more fish.

15.51 Industry input into knowledge gathering. The Department has increased its effort to improve understanding of the biology of cod and, to a lesser degree, the other groundfish species. The Department has included the knowledge of fishers in the assessment of stock status, through fisher participation in the Regional Advisory Process review of the initial draft stock status report. In 1993, the Fisheries Resource Conservation Council was established, in response to the collapse of the groundfish stocks, to provide advice to the Minister on groundfish conservation issues, including appropriate quota levels. Council members are appointed by the Minister and include independent academics and representatives from industry, the provinces and the Department.

15.52 While industry participation has been beneficial in gaining industry acceptance of the stock assessments, the Science Branch has not been able to fully incorporate into the stock assessment process the information gained from the work conducted by fishers. This is especially true of the work conducted under the sentinel fisheries (a small-scale fishery that provides data on catch rates, distribution, migration, population structure and condition of fish and that is conducted by fishers using traditional gear types under the Department's direction and government funding). Among the problems associated with the sentinel fisheries are that they provide information for only two years, which is not long enough for appropriate analysis, and they are more expensive than the comparable coverage provided by the ongoing science program.

15.53 Research surveys. The research surveys conducted by the Department's scientists represent the longest-running series of independently gathered data about the status of individual groundfish stocks. The reliability of these data is dependent on an understanding of the biology of the surveyed stock. For example, the Department acknowledged that it did not have a good understanding of the composition and movement of the various cod stock components for the Northwest Atlantic Fisheries Organization (NAFO) fisheries zone 3Ps cod. The timing of the research survey has varied considerably over time (mostly February or April). The 1996 stock status report indicates, "The origins of fish that make up the 3Ps cod fishery are diverse and as yet not fully understood."

15.54 Guiding principles. The preceding chapter referred to the absence of measurable indicators related to the Department's guiding principles for the fishery of the future. The Department has indicated that to achieve a sustainable use of the stock, it must adopt such concepts as "new biological references to avoid critical zones" and the "precautionary approach to decision making". In the past, reference points have been used but have not been effectively implemented. To date, the Department has not established any new biological references for use in the management of each of the individual groundfish stocks. The Fisheries Resource Conservation Council has provided examples of potential biological references in its report *From Moratorium to Sustainability: Criteria for Re-opening and Sustainable Harvesting*, but no action has been taken to implement these or any other potential guidelines.

15.55 In addition, key conservation decision rules have not been established to help guide decision making when applying the precautionary approach. The precautionary approach is described in Chapter 14, Exhibit 14.13. Department scientists are taking part in projects with various international organizations for the development of guidance on the precautionary approach. It is important that international organizations develop and agree upon guidance for the precautionary approach. Meanwhile, guidance that can be applied to the Atlantic groundfish stocks is required. Exhibit 15.8 reflects some of the difficulties associated with applying the precautionary approach in the absence of formal guidance.

Exhibit 15.8

Reopening of the 3Ps Cod Fishery and the Application of the Precautionary Approach

On 17 April 1997, the Minister announced his decision to allow 10,000 tonnes of cod to be caught in NAFO fishing zone 3Ps or approximately 30 percent of the quota prior to the moratorium. The decision to reopen the 3Ps cod fishery was made after receiving the recommendation of the Fisheries Resource Conservation Council (FRCC) and advice from the Department.

Sources of information for the decision on 3Ps included the stock status report, the inshore sentinel fishery and public input to the FRCC. These sources provided information that was contradictory and raised uncertainties about the status of the stock. How was the precautionary approach applied in this instance?

Some major uncertainties raised in the stock status report include the following:

- The research vessel survey did not show any increase in the estimates of abundance in the offshore areas; historically, these areas are where the largest portion of the biomass would be found from late fall to early spring of the year.
- Scientists did not feel that they could provide a credible estimate of the total or spawning stock biomass.
- The stock is heavily dependent on fish that were spawned in 1989, with negligible recent recruitment of young fish.
- The productivity of the fish still remains at the lowest levels observed.

The stock status report itself leaves the reader with uncertainty. For example, the report states, “Based on the available data, a limited re-opening of the inshore fixed gear fishery may not compromise the recovery of the stock.” The report highlights the risks of depletion of the stock, given its current state, but does not suggest a specific level of harvest.

We are not concluding that the precautionary approach was not applied in this decision. We believe that the 3Ps example points to the difficulty of making resource utilization decisions in situations of uncertainty and the need for guidance in applying the precautionary approach.

Further, it should be noted that the 1997 conservation harvesting plan for the 3Ps cod fishery contained many conservation measures designed to ensure that the quota was not exceeded. Such conservation measures were not in place prior to the moratorium.

15.56 The Minister requested the Fisheries Resource Conservation Council (FRCC) to develop a conservation strategy for Atlantic groundfish. The Department and the Council have worked together on developing concepts included in FRCC reports, including the recent FRCC report *A Groundfish Conservation Framework for Atlantic Canada*. Nevertheless, the Department has not yet achieved agreement with industry on long-term objectives for each of the groundfish stocks. Without biological reference points as guideposts, decisions on the use of individual stocks could be influenced by current social and economic factors rather than their biological sustainability. We noted that improvements have been made in the type of information presented in certain stock status reports, in the timeliness of information used in the stock assessments and in the interaction between industry and the Department in the stock assessment process.

Resource management planning is evolving

15.57 The Department had planned, as a part of its fisheries renewal initiatives, to develop an integrated approach to producing management plans for the 1996 fishing season in the groundfish fishery. This integrated management planning process was to have considered such things as:

- long-term objectives for each fishery;
- current management issues;
- key management measures for the upcoming year;
- conservation and protection issues and strategies;
- industry responsibilities; and
- evaluative criteria.

15.58 While the Department has not yet formalized its integrated management planning process for groundfish, there has been progress toward this concept in the significant fisheries off southwest Nova Scotia. Industry and fisheries management have undertaken an ongoing series of meetings designed to deal with management and conservation issues. However, even in this area, we noted numerous cases where management planning was not conducted in an integrated fashion. For example, long-term objectives were not established and enforcement considerations were not incorporated into the management plans.

15.59 Conservation harvesting plans (CHPs) were initially introduced for the management of certain stocks that were in decline. CHPs are prepared by the various groundfish fleet sectors and include different conservation measures that each sector will follow, such as spawning area closures, gear selectivity and bycatch limits. During the 1996 season, all groundfish fleet sectors had to prepare a CHP and obtain approval for it from the Department before they began fishing.

Catch monitoring processes have deficiencies

15.60 The Department has two main processes to monitor catches; namely, the dockside monitoring program and the at-sea observer program. The purpose of these processes is to provide fisheries managers with timely, complete and accurate commercial catch data to manage fisheries, including the stock assessment process. The dockside monitoring program has been gradually introduced to different fisheries since 1992. The program calls for fishers to self-report, through the dockside monitoring organizations, on fish landings. Under the previous system, the fish buyers reported their purchases.

15.61 Dockside monitoring program. The dockside monitoring program has become the Department's key source of data on the amount of fish landed. Under this program, fishers procure the services of a dockside monitoring organization to monitor and report on their landings of fish. The individual dockside observers hired by the organizations are certified to perform their duties by Fisheries and Oceans Canada. While this program represents an improvement over the previous system, we observed weaknesses in the control environment for dockside monitoring, which include the following:

- The Department does not have the authority to control the activities of the organizations that carry out the monitoring. For example, it has established standards for the conduct of dockside monitoring but has no authority to ensure that the organizations work to those standards.
- The Department cannot ensure that the organizations that carry out these activities and the observers whom they employ are independent of the fishers they monitor.
- The Department has not undertaken sufficient measures to determine whether the dockside monitoring program is producing complete and accurate data.
- The Department has not evaluated the dockside monitoring program's effectiveness in contributing to groundfish conservation.

See Exhibit 15.9 for examples of specific deficiencies noted in the Department's dockside monitoring activities.

Exhibit 15.9

Deficiencies in Dockside Monitoring Program

Examples of specific deficiencies in dockside monitoring activities:

- The Maritime region has conducted administrative reviews of the dockside observers and spot checks by enforcement officers. These reviews have noted instances where the observer could not identify species of fish, did not ensure that the fish were properly weighed and did not check that the vessel was completely offloaded when the landing was complete. The Department has not quantified the potential error resulting from these weaknesses.
- The dockside monitoring program is not always carried out by organizations that are at arm's length with the harvesting sector. For example:
 - In the Newfoundland region, dockside monitoring is conducted by an organization associated with the union that represents the vast majority of fishers in the region.
 - In the Maritime region, one of the dockside monitoring companies is predominantly owned by family members of fishers engaged in groundfish harvesting.
- The Department does not require that all fish be weighed at the wharf. In some instances, fish are moved from the vessel to the processing plant, which can be a significant distance from the unloading site. This increases the possibility that dockside observers would not be able to ensure that all fish landed would be included in the Department's catch data systems.

15.62 At-sea observer program. It is very difficult for the Department to get good information on the industry fishing practices at sea. The at-sea observer program is one means by which the Department's fisheries managers have historically obtained such information. In this program, the Department has independent observers accompany and monitor fishers while they are engaged in fishing activity. The observers obtain data and information vital to the stock assessment process and other important fisheries management activities.

15.63 A benefit and also a limitation of the at-sea observer program is that fishers are not likely to conduct unsustainable fishing activities when an observer is onboard. However, only the largest of fishing vessels have 100 percent coverage by observers; all other vessels are observed on a percentage basis. Therefore, the impact of the program may be limited to those vessels that are observed. To overcome this, the Department could prepare an "index" of the catches by observed vessels or vessels that have been subject to at-sea surveillance by enforcement officers. This "indexed" catch would then be compared with the catches reported by all of the other vessels. While this type of analysis can be very complex and difficult to complete, it would yield important information about the unsustainable practices of industry and would support the Department's enforcement activities.

15.64 For example, we identified an analysis completed by departmental officials for one groundfish fleet sector in southwest Nova Scotia. This study established an estimate of the extent of unsustainable fishing practices in that fleet during a given period. The Department has not developed a systematic approach that integrates at-sea observer and other information into its management practices.

15.65 In the future, the Department will require industry to pay for the at-sea observer portion of the cost of the program. The level of observer coverage for each fleet sector will be subject to negotiation between the Department and industry. The Department has not yet developed standards for at-sea observer coverage that could assist in its negotiations with industry.

Enforcement is not fully integrated into groundfish management

15.66 As stated in paragraph 15.11, fisheries management planned to increase its sharing of management responsibilities with industry. As part of that strategy, the Department moved to reorient the activities of its Conservation and Protection Branch (referred to as enforcement), from an emphasis on enforcement of fisheries regulation to auditing, where possible, programs of monitoring funded by industry and run by private enterprises (such as dockside monitoring and at-sea observers). The Department has made limited progress toward this objective. During the audit, the Newfoundland region started to make changes to its enforcement function and the Branch has started developing work plans based on a risk analysis.

15.67 Existing information systems do not always meet enforcement needs. Our review of the catch monitoring processes indicated that they do not provide the information needed for effective enforcement. For

example, the information received from both the at-sea observers and the catch data system does not give enforcement officers the lead time to plan their enforcement activities. In addition, there are problems associated with the data being used by the enforcement function. The Department is aware of these problems and has a project in place that, among other things, will attempt to provide the information that the enforcement function needs. In addition, the Department has indicated that there is a need to train enforcement officers in the use of the existing information systems.

15.68 Groundfish not always given enforcement priority. We observed that in most districts with significant groundfish fisheries, enforcement effort has been diverted away from the groundfish industry to other fisheries where the potential is greater for successful identification of violations of fisheries regulations. In these districts, enforcement officials informed us that they do not have the resources and/or understanding of what the Department expects of them when conducting enforcement for groundfish. In 1996, the Department removed several administrative responsibilities (for example, the issuing of licences) from the enforcement function, which should allow for more time to be spent on enforcement duties.

15.69 Sanctions. When the Department catches a fisher violating regulations, it has the authority to charge the individual and have the fisher tried before a court of law. In 1993, the Department developed the Administrative Licence Sanction Policy under which, should a serious conservation-related offence occur, the Regional Director General could apply an additional sanction or suspend the right to fish for a period of time.

15.70 While some regions have applied the sanction policy aggressively, others either have failed to apply it at all or have only partially implemented it. The implementation of the policy was left to the discretion of the regional officials, which accounts for the differences in its application.

15.71 The legality of the policy has been challenged on several occasions. Due to recent court rulings, the legal status of the policy is not clear. While the Department is appealing these recent decisions, it has indicated that it will continue to prosecute violations through the courts while sanction action is put on hold. The Department and the industry have indicated that sanctions are an important mechanism to deter unsustainable harvesting practices.

15.72 The Department should:

- **improve its catch monitoring systems to ensure the accuracy and completeness of the commercial catch data that are used for fisheries management and stock assessment purposes;**
- **develop working interpretations or definitions of such key principles or concepts as the precautionary approach and biological reference levels;**
- **ensure that integrated fisheries management plans link the Department's conservation principles and related measurable objectives with departmental resource planning for individual fisheries;**
- **address the weaknesses in the dockside monitoring program;**
- **ensure that enforcement is an important and active function that is conducted based on an appropriate analysis of conservation risks and that provides assurance about the effectiveness of catch monitoring processes; and**
- **ensure that enforceable mechanisms for deterring unsustainable harvesting practices are in place.**

Department's response: The Department agrees that improvements can be made to strengthen conservation management practices, and has initiatives under way to address the issues identified. Internal controls are being redesigned to improve the reliability of catch information from dockside monitoring programs. Integrated Fisheries

Management Plans are being designed by the Department in co-operation with representatives of fleet sectors in the Atlantic. The enforcement program is being redesigned and strengthened. Stringent groundfish reopening measures have been adopted for deterring unsustainable harvesting practices. The Department has been and continues to be highly influential in the development of the precautionary approach to fisheries management. The Department notes that the precautionary approach is a new concept (outlined at the 1995 Conference on Straddling Fish Stocks and Highly Migratory Fish) for which biological reference points and conservation decision rules have not yet been established anywhere in the world. International Commissions such as the Northwest Atlantic Fisheries Organization and the International Council for the Exploration of the Sea are currently working on this issue and the Department will continue to work closely with the Fisheries Resource Conservation Council on the development and implementation of a Groundfish Conservation Framework for Atlantic Canada.

Conclusion

15.73 The Atlantic Groundfish Strategy (TAGS) and other related initiatives such as licensing reform, unemployment insurance reform and fisheries management changes have not resulted in the removal of a significant amount of real or “fish catching” harvesting capacity that existed in the period prior to 1992. The Strategy and the other initiatives targeted the removal of 50 percent of the groundfish licences as the capacity reduction objective over the long term. The decrease in TAGS capacity reduction funding from \$300 million to \$97 million had an impact on the Department’s ability to remove more licences. For the most part, the licence holders removed or to be removed by the initiatives do not represent the fishers that historically caught most of the fish.

15.74 Since the introduction of TAGS, the number of licences that have been removed represents approximately four percent of the licences that existed at that time. A further 19 percent have been targeted for eventual removal through the Atlantic licence review. The changes to the licensing policy effectively put a cap on the number of groundfish licences in the future. The eventual removal of approximately 23 percent of the groundfish licences shows progress but overcapacity still remains.

15.75 Past management practices were introduced with the objective of achieving conservation, but, for various reasons, without success in protecting the resource base. Since 1992, the Department has been introducing further changes to its groundfish management activities. Since 1994, these changes have been focussed on the Department’s strategy that flowed from the Program Review exercise. We found that improvements have been made in certain fisheries management activities, but there are areas where progress has been slow or deficiencies of the past continue to exist. These areas include implementing a precautionary approach to conservation and improving catch monitoring and enforcement.

15.76 Changes planned for the renewal of fisheries management are based on the assumption that the restructuring of the industry and the changes in its relationship with the Department will take place. In the groundfish sector, few fisheries management responsibilities have been transferred to industry. The transfer has not occurred in part because of legislative limitations but also due to the inability of some segments of the industry to accept greater responsibility. We are concerned about the potential conservation impacts of changes to fisheries management without the planned transfer of increased responsibility and accountability to industry occurring at the same time.

Department’s comments: *This report confirms the significant role of the fishery in the economy of Atlantic Canada and the importance of ensuring that the fishery resource is capable of supporting a sustainable fishery industry. The Department believes that it is important to “stay the course” and continue with its program of Fisheries Management Reform and Renewal. While more needs to be done, much has been accomplished to ensure the conservation of Atlantic fisheries, including:*

- *science partnership with industry such as for sentinel fisheries;*

- *creating the Fisheries Resource Conservation Council;*
- *a new Atlantic commercial licensing policy;*
- *implementation of capacity reduction measures to the full extent of the Department's authority;*
- *strengthening of fisheries enforcement;*
- *the Canada–European Union Agreement to curtail foreign overfishing;*
- *new management structures such as integrated fisheries management plans and partnerships or co-management arrangements;*
- *collaboration with industry on a code of conduct on responsible fishing; and*
- *industry conservation harvesting plans involving: small fish protocols, zero tolerance for discarding, tightened bycatch control, spawning and juvenile fish closures, effort reduction and control, improved dockside monitoring, at-sea observers, and gear selectivity and restrictions.*

Working together with the fishing industry, the Department of Fisheries and Oceans is committed to conservation and a sustainable fishery.

About the Audit

Scope and Approach

The main subject of this audit was the industry rationalization and fisheries renewal initiatives and their impact on the Atlantic groundfish industry. The audit covered the capacity reduction elements of The Atlantic Groundfish Strategy, and other fisheries management initiatives that are listed in Exhibit 15.1. It should be noted that several other initiatives could have some impact on Atlantic groundfish rationalization but were not the subject of this audit. They include unemployment insurance reform and access fee increases. These areas were not covered in this audit as their impact on industry rationalization would be indirect.

The Atlantic groundfish industry is regulated by both the federal and provincial governments. The federal government is responsible for the harvesting sector and the export of fish products from Canada, while the provincial governments are responsible for the processing sector. The regulation and management of the Atlantic groundfish processing sector has significant impacts on the federal government's management of the harvesting sector. For example, the existence of overcapacity in the processing sector puts significant pressure on the federal government to provide groundfish necessary to operate the plants. While we have taken the processing sector into account during the conduct of the audit, it was not the subject of the audit.

Objective

This chapter assesses whether fisheries management practices for the Atlantic groundfish fishery have resulted in progress in dealing with the fundamental problems in the fishery. In addition, it assesses the extent to which the capacity rationalization initiatives administered by the Department have contributed to the achievement of both fisheries management and The Atlantic Groundfish Strategy objectives.

Criteria

We would expect that:

- fisheries management practices would ensure that industry capacity is in balance with fisheries resource levels;
- fisheries management practices would ensure appropriate involvement of industry and communities and ensure that industry is held accountable for following sustainable fishing practices; and
- groundfish management practices (science, fisheries management and enforcement) would implement the principle of conservation to ensure sustainable stocks.

Audit Team

Glenn Doucette
Kathleen Hobbs

Donald MacNeill
Kevin Potter
Kimberlea Redden
Michael Ryan

For information, please contact Doug Timmins, the responsible auditor.

Chapter 16

Human Resources Development Canada — The Atlantic Groundfish Strategy

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Human Resources Development Canada — The Atlantic Groundfish Strategy

Assistant Auditor General: David Rattray

Responsible Auditor: Louis Lalonde

Main Points

16.1 The accountability framework for The Atlantic Groundfish Strategy (TAGS) has significant weaknesses that have had an impact on the value obtained for money spent. These include the following:

- the responsibilities of the organizations charged with developing and implementing TAGS were not clearly defined or agreed upon in a memorandum of understanding;
- no overall strategic plan was established to identify and schedule the activities of the organizations responsible for implementing TAGS and to determine the indicators and performance expectations to be used, monitored and reported on;
- no formal co-ordination mechanism was envisaged, even though TAGS involved joint activities because of its interdependent components; and
- the information submitted to Parliament did not make it possible to determine progress toward TAGS objectives of restructuring Atlantic Canada's fishing industry to make it economically viable and environmentally sustainable.

16.2 The timetable for developing an initiative as important as TAGS was unrealistic. It was not geared to the restructuring of the industry. The funds (\$1.9 billion) were distributed according to a preliminary strategy, but subsequently had to be reallocated among TAGS components because of major changes to the initial strategy and because forecasts of the eligible population had been too low.

16.3 The information needed to assess participant eligibility was not always available. Because clear, accurate information was difficult to obtain, decisions were made on the basis of incomplete information that did not meet the requirements of TAGS eligibility criteria. Errors in applying the criteria were noted from the time TAGS was implemented, and many corrections had to be made. Varying interpretations of the eligibility criteria resulted in different treatment of participants in various areas.

16.4 The results of the labour adjustment component of TAGS will not be known. Program evaluation efforts were abandoned when the Strategy changed from an active participation strategy to a passive one. We are concerned that the information gathered and the lessons learned during an initial evaluation of program development and implementation may be lost and that results will not be accounted for.

16.5 The government proposes to review the longer-term issues arising from the elimination of TAGS foreseen in May 1998. We urge the government to examine carefully the consequences and impacts of the decisions made under TAGS in order to benefit from the valuable lessons that can be learned.

Introduction

16.6 This is one of three chapters on the fisheries of the future. It focusses on The Atlantic Groundfish Strategy (TAGS), in particular the labour adjustment component, for which Human Resources Development Canada is responsible, and the accountability framework. Chapter 14 deals with the historical, biological, economic and social context in which Fisheries and Oceans Canada manages groundfish, and reviews the causes of the current crisis and the federal government's response to it. Chapter 15 examines Atlantic groundfish fishery management practices to determine whether they have led to progress in resolving the basic problems in the fishing industry, and establishes the extent to which capacity reduction efforts administered by Fisheries and Oceans have contributed to the implementation of TAGS.

The Atlantic Groundfish Strategy

16.7 In July 1992, the Northern Cod Adjustment and Recovery Program (NCARP) was introduced to assist fishers and plant workers affected by the two-year moratorium on the northern cod fishery. In April 1993, the Atlantic Groundfish Adjustment Program (AGAP) was also put in place to assist fish plant workers affected by declining groundfish stocks. Both NCARP and AGAP expired on 15 May 1994.

16.8 In the winter of 1993-94, the Fisheries Resource Conservation Council determined that, despite the northern cod moratorium and the reduction in groundfish quotas in December 1992, groundfish stocks were continuing to decline. The Cashin Task Force reported in November 1993 that the groundfish industry was facing a crisis of catastrophic proportions, and that fish stocks would not return to commercially exploitable levels before the end of the century. The report stressed that the groundfish industry of the future would be smaller, and that over half the jobs in the fishery would disappear.

16.9 In response to the crisis, the Minister of Finance announced, in the February 1994 Budget speech, a five-year program for the long-term adjustment of the Atlantic groundfish fishing industry. The Atlantic Groundfish Strategy was announced in April 1994, and came into effect on 16 May 1994. It covered fishing areas in five provinces: Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick and Quebec. TAGS provided assistance programs for individuals and communities affected by the groundfish moratorium. The development of the Strategy was based on a set of guiding principles (see Exhibit 16.1).

Exhibit 16.1

Guiding Principles for the Development of The Atlantic Groundfish Strategy (TAGS)

TAGS should:

- provide an integrated approach to capacity reduction and the adjustment of communities and individuals affected by the moratorium;
- call for partnerships with all stakeholders;
- identify a core group of professional fishers;
- harmonize active adjustment measures to the future needs of the groundfish fishery;
- emphasize career planning and employment counselling;
- link income support to active adjustment measures and take fiscal realities into account;
- base applicant access and eligibility duration on previous attachment to the groundfish fishery;
- emphasize sustainable development and Atlantic Canada's long-term economic development;

- recognize that the industry will be restructured to reduce capacity by 50 percent.

TAGS must not:

- be constrained by current policy and programs;
- in the absence of the fishery, base income support on unemployment insurance.

16.10 The objectives of TAGS were to restructure the fishery industry in Atlantic Canada to make it economically viable and environmentally sustainable by:

- renewing the resource and reducing harvesting and processing capacity;
- facilitating the labour adjustment of individuals affected by the Atlantic fishery crisis;
- enhancing the profession of those fishers who remained active in the fishery industry; and
- facilitating community economic development by focussing on regional strengths and opportunities in the areas affected by adjustments in the fishery industry.

16.11 The implementation of TAGS involved four federal government organizations and had a fixed budget of \$1.9 billion over five years. The allocation of these funds was adjusted as the Strategy evolved. The duration period will be about four years and funds are currently allocated as follows:

- the Department of Fisheries and Oceans (DFO), responsible for the restructuring of the fishing industry (\$97 million);
- Human Resources Development Canada (HRDC), responsible for labour adjustment, including income support (\$1.748 billion); and
- the Atlantic Canada Opportunities Agency (ACOA) and the Federal Office of Regional Development - Quebec (FORD-Q), responsible for community and regional economic development (\$50 million).

16.12 These organizations were also to work with provincial and municipal governments, educational institutions and the private sector to implement TAGS.

16.13 TAGS incorporated complementary and interdependent activities. The first step was to identify a core group of fishers and fish processing plants that would continue to be part of the fishing industry. Identifying this core group would allow adjustment measures to be directed according to participants' needs. Long-term regional and community economic development would subsequently increase employment opportunities and guide the direction of training.

16.14 Income support was to be provided to fishers, trawler workers and plant workers affected by the Atlantic groundfish crisis who agreed to participate in the labour adjustment programs offered under TAGS. The active participation measures were designed to facilitate access to employment through, for example, career planning and counselling, mobility assistance and support for re-employment; to prepare individuals for work through, for example, literacy and basic skills training; and to enhance employment opportunities through such means as support for entrepreneurship and restoration of the environment and communities. Human Resources Development Canada also administered the early retirement program for older plant workers.

16.15 Complementing the measures under TAGS, Unemployment Insurance was changed to Employment Insurance effective in January 1997. The aim was to help those most in need and to provide incentives for beneficiaries to return to work. Changes were introduced to solve basic structural problems such as “disincentives” to work, dependence on unemployment insurance, administrative complexity and inequities in the system. The effects of these measures will not be known for a number of years. In May 1997, the Government of Canada announced that a temporary change would be made to the Employment Insurance Regulations that would enable all TAGS beneficiaries to qualify for unemployment benefits under regular entrance requirements.

Focus of the audit

16.16 The objectives of this audit were to determine whether:

- the income support and labour adjustment programs administered by Human Resources Development Canada contributed in an economical and efficient way to the achievement of TAGS objectives; and
- an effective accountability framework had been established for TAGS.

16.17 Details of our audit scope and criteria can be found at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

An Incomplete Strategy

16.18 The Atlantic Groundfish Strategy was developed quickly by HRDC and Fisheries and Oceans, between January and April 1994. Subsequently, to take into account unforeseen events and additional factors not thought of initially, many changes had to be made. Exhibit 16.2 summarizes the development of TAGS and shows that, in order to meet its income support commitment, between January 1995 and July 1996 the government had to reprofile funds from its planned measures to reduce fishing capacity, from its labour adjustment measures for active participation, and from administration. Moreover, to avoid exceeding the financial envelope, TAGS will end when funds are exhausted, which could be as early as May 1998, one year earlier than planned.

Exhibit 16.2

Development of The Atlantic Groundfish Strategy

Decisions finalizing or modifying TAGS	
March 1994	Approval of guiding principles and the financial envelope of \$1.9 billion
April 1994	Approval of the spending profile for the next five years and the Labour Adjustment component
May 1994	TAGS becomes effective
October 1994	Approval of the Fishing Industry Restructuration component
July 1996	Harmonization of income support payments with employment insurance, as of 1 August 1996: <ul style="list-style-type: none"> • an income ceiling of \$26,000 to be placed on eligibility for TAGS income support • eliminating eligibility for TAGS income support during the two-week waiting period for

	TAGS participants who are entitled to employment insurance benefits
Decisions to avoid exceeding the financial envelope of \$1.9 billion	
January 1995	HRDC active participation programs are more carefully targeted to reduce the projected TAGS deficit by \$385 million
July 1996	Measures taken as of 1 August 1996 to prevent a projected deficit of \$500 million: <ul style="list-style-type: none"> • Human Resources Development Canada - of the funds earmarked for administration and active labour adjustment measures, \$190 million to be allocated to income support • Department of Fisheries and Oceans - of the funds earmarked for licence retirement, \$105 million to be allocated to income support • income support payments to be maintained at current levels
May 1998	TAGS to terminate when the funds are exhausted, which could be one year earlier than planned (\$178 million)

16.19 Because TAGS was replacing two earlier programs that terminated on 15 May 1994 (see paragraph 16.7), a transition period of nine months was provided to maintain continuity. The deadlines for submitting applications varied according to the clientele. The labour adjustment component had to be developed and approved before TAGS came into effect, and mechanisms for applying to TAGS and for the initial payment to participants had to be put in place quickly. Exhibit 16.3 shows the timetable established by HRDC for the first year of TAGS.

Exhibit 16.3

Implementation Timetable - Human Resources Development Canada

Planned Date	Activity
April 19, 1994	Announcement of TAGS
April 21, 1994	Mailout of application forms and explanatory letters to all participants of the Northern Cod Adjustment and Recovery Program (NCARP) and Atlantic Groundfish Adjustment Program (AGAP)
May 15, 1994	End of NCARP and AGAP benefits
May 16, 1994	TAGS becomes effective
May 30, 1994	First transition cheques are issued (covering the period May 16-29) and payments to new applicants and those rolled over
June 1, 1994	Initial contact with qualified clients (information and counselling)
July 1, 1994	Career planning and formulation of an action plan for eligible clients (includes selection of program options)
July 9, 1994	Last day of benefits for NCARP and AGAP roll-over beneficiaries who did not submit an application form under TAGS
July 1 to December 31, 1994	Identification of a core group of fishers
December 31, 1994	End of transition period. Benefits end for those rolled over but not eligible under TAGS
December 31, 1994	Last day to apply for the Fisher and Plant Older Worker Adjustment Program

March 31, 1995

Last day to submit an application form under TAGS

Source: *The Atlantic Groundfish Strategy (TAGS) Guide*, Human Resources Development Canada, December 1994.

16.20 TAGS was not fully developed when it came into effect on 16 May 1994. The partnerships needed to implement the Strategy's proposed concepts still had to be negotiated and TAGS components related to industry restructuring and economic development had not been finalized.

16.21 Income support was intended for those affected by the groundfish moratorium. To be eligible for TAGS programs, applicants had to agree to participate actively in labour adjustment measures (Exhibit 16.4 presents a profile of TAGS participants). It was therefore important that participants have a clear picture of their status. To be able to make career decisions early in the Strategy, eligible fishers and plant workers had to know if they could expect to be part of the industry in the long term or if they should find another job or retire.

Exhibit 16.4

Profile of Participants Eligible for The Atlantic Groundfish Strategy

	Men	Women	Total
Number of eligible participants as of 31 March 1997	22,519	11,581	34,100
Without high school education			73%
Age:			
<35	35%	28%	33%
35-54	55%	64%	58%
55+	10%	8%	9%
Family status:			
Spouse and children	51%	50%	
Spouse, no children	30%	37%	
Single parent	1%	5%	
Lives alone	5%	3%	
Others	12%	5%	
Other family members eligible for TAGS	37%	51%	42%

Source: Human Resources Development Canada

16.22 These were potentially complex decisions for individuals. TAGS participants had to consider factors like choosing a career direction, finding out what jobs were available and where, and what type of effort would be required, as well as reconciling personal needs with those of their families. Knowing which enterprises would be targeted by reduction efforts was thus a priority.

16.23 Initially, TAGS planned to identify by June 1994 a core group of fishers and fish processing plants likely to be part of the fisheries of the future, based on criteria to be established in consultation with the provinces and the industry. Federal measures of capacity reduction -- early retirement and fishing licence buybacks -- would apply to fishers in that group.

16.24 As early as August 1994, Fisheries and Oceans acknowledged that reduction of fishing capacity would occur only in the long term, and that TAGS measures would be limited to areas of federal jurisdiction and would not alone be enough to reduce the industry by the desired 50 percent. Other measures such as unemployment insurance reform, a new licensing policy, the establishment of permanent agencies, provincial reduction of fish

processing capacity, and economic development would have to be part of the solution. However, the impact of this new direction on the costs and operations of the other TAGS components was not assessed when the decision was made, and proved to be one of the factors in the increased demand for funds allocated to income support.

16.25 For the purposes of TAGS adjustment and industry reduction measures, the core group of fishers and fish processing plants was limited by Special Eligibility Criteria applicable only to groundfish fishers. By the summer of 1995, Fisheries and Oceans had identified some 6,200 fishers as qualifying under these criteria. Subsequently, a similar process took place but for licensing purposes and 9,800 fishers were designated in early 1996 as qualifying for the fishery of the future. In December 1996, a further review designated 10,435 groundfish fishers to be part of the fishing industry (see Chapter 15, paragraphs 15.24, 15.27 and 15.29). These successive processes did not serve to clearly identify individual situations.

16.26 The proposed community economic development measures to be developed by ACOA and FORD-Q were intended to create jobs in the communities affected by the restructuring of the fishing industry. Active labour adjustment measures could have led TAGS participants to direct their adjustment efforts toward the job opportunities thus created. In January 1995, HRDC still did not know what direction these measures would take.

16.27 The development and implementation of TAGS did not help the eligible population to understand the situation it was facing. The enterprise closures and layoffs that would result from the restructuring of the industry remained impossible to foresee, as did future opportunities for other employment.

Optimistic funding forecasts

16.28 The number of participants eligible for TAGS was 51 percent higher than expected. The forecast of costs of income support over five years had been based on an estimated eligible population of 26,500 participants (Exhibit 16.5 shows the difference between forecast and actual eligible population). Of the nearly \$2 billion devoted to TAGS, 76 percent is currently allocated to income support, whereas the forecast had been 36 percent. Many of the factors used to establish the forecasts had been either underestimated or overestimated.

Exhibit 16.5

(This exhibit is not available, see the Report)

16.29 There were no existing data on the number of days spent on groundfish fishing over the course of a year, or on the percentage of a fisher's income that it provided. Similarly, there were no data on the time spent by plant workers to process groundfish or on the income they derived from it.

16.30 The forecasts were therefore based on the number of participants in previous programs. Fisheries and Oceans data on fish plant workers were based on employee lists at a given time, whereas HRDC data included all individuals who had worked in the sector and had paid unemployment insurance contributions. Consequently, their estimates of TAGS target population were inconsistent, at 31,000 and 39,000 respectively.

16.31 The departments had even less information on the population that had not been affected previously by a moratorium. Consequently, they had to make assumptions about the number of potential participants and these may have greatly influenced the forecasts.

16.32 TAGS eligibility criteria had to be adjusted to this situation. They targeted individuals who worked in a fishing enterprise or fish plant for which groundfish represented at least 25 percent of its landed value or its processed volume. While individuals qualifying for TAGS under these criteria may have worked only in groundfish-related activities, as the available data pertained to establishments and not the individuals, others could qualify who had no attachment to the groundfish (see paragraphs 16.53 to 16.62).

16.33 Although the income support rate under TAGS was six percent lower than under the Northern Cod Adjustment and Recovery Program, the economic environment and several aspects of TAGS encouraged a high participation rate. The continuing decline in groundfish stocks discouraged fishing in the sector, and so it became increasingly difficult for individuals dependent on the groundfish fishery to accumulate enough insurable weeks of work to qualify for unemployment insurance benefits.

16.34 Individuals eligible for the entire duration of TAGS had the choice between a guaranteed income with regular payments over the course of the year, and seasonal employment to which unemployment insurance benefits could be added (or social assistance if they did not have enough weeks of work to qualify for unemployment insurance). Being part of a core group of fishers and fish processing plants and ultimately part of a more stable industry than before, and with a potentially higher rate of income, was an attractive prospect. However, these factors were not taken into account by HRDC and Fisheries and Oceans in forecasting the rate of participation.

16.35 According to an HRDC evaluation study, median income in the first complete year of TAGS (1995) was estimated at \$14,721; median annual income in the four years preceding the closure of the fisheries (1988-91) had been \$14,668.

16.36 A normal attrition rate determined by the eligibility formula and an annual abandonment rate of 10 percent were used to forecast the cost of income support. It was estimated that only 8,500 participants or 28 percent of the forecast population would remain in TAGS by 1999. According to current data, there are 21,722 participants whose eligibility ends in 1999, or 54.2 percent of the eligible population.

16.37 The abandonment rate took into account those who would leave the program for reasons other than the termination of their eligibility or the selection of an exit option. However, it did not take into account the special circumstances that might create obstacles to labour adjustment. The geographical distribution of unemployment, with especially high rates in small isolated communities, was one of these obstacles. Another was the lack of alternative employment, as stressed by TAGS. At the end of March 1997, the abandonment rate since the start of TAGS was 0.5 percent.

16.38 The capacity reduction measures were expected to lower the number of TAGS participants by 5,400. Aside from the cost of the reduction measures, no other costs related to these participants were forecast. The cost of a one-year delay in capacity reduction was estimated at \$85 million in transitional aid and \$80,000 per participant who remained eligible for TAGS throughout its duration. Licence buybacks took place only in October 1995 and August 1996, and led to a reduction of 478 groundfish licence holders. Only 333 fishers and crew members took early retirement.

16.39 Complete, reliable data on the target population were not available. The respective impacts of various participation rates and sizes of the eligible population were not analyzed. The main factor emphasized was the additional cost per participant if an assumption proved to be inaccurate. Because of time constraints, alternative strategies were not considered even though it was recognized that the proposed strategy was based on assumptions that might not materialize.

16.40 Exhibit 16.6 shows the changes in funding available for labour adjustment. The present strategy no longer pursues the original HRDC objective of helping participants adjust out of the groundfish sector by preparing them for the labour market. In August 1996, two years after implementation, the strategy changed from active to passive participation.

Exhibit 16.6

(This exhibit is not available, see the Report)

16.41 In summary, the timetable to develop a strategy of the magnitude intended for TAGS was not long enough. The implementation date was chosen to maintain continuity with the former programs, particularly income support,

and not to serve the objective of restructuring the fishing industry. When it came into effect, TAGS was not sufficiently developed for all stakeholders to adhere to its objectives and underlying concepts.

16.42 In contemplating any future initiatives of this magnitude, the government should ensure that departments have enough time to develop strategies that take into account completed analyses and possible options.

Department's response: While HRDC agrees that it is desirable for departments to have adequate time to develop such strategies so that complete analyses can be performed and possible options considered, and would have liked this to have existed for TAGS, the audit report does not note that there was an important urgency to get benefit payments to people who had lost their livelihood. This urgency warranted, in our view, the attempt to meet these objectives, imperfect as it may have been.

HRDC management responded to the implementation challenge

16.43 The difficulties encountered in the development of TAGS impacted on the management of its implementation. Management had to deal with heavy workloads to meet the needs of participants when key elements of the strategy were not yet available. Important constraints throughout implementation required from managers a considerable amount of flexibility and capability to adapt quickly to changing circumstances.

16.44 Setting up the systems to issue payments, process applications and assess eligibility were the main concerns of the staff involved in TAGS over the first 12 months. Numerous systems problems arose over the first few months, slowing down operations. There were overpayments and underpayments because of misinterpretations or systems errors. For example, differences in the income reporting periods between unemployment insurance and TAGS, as well as the lack of automatic reconciliation between the two systems, led to inaccuracies in payments.

16.45 In addition to systems that required strong analytical capabilities, there were complex eligibility procedures that were linked to employment in previous years and required an exhaustive database. HRDC had to make considerable efforts to make its systems usable for TAGS. This left little time for efforts directed to labour adjustment out of the industry.

16.46 The Department had planned, since the beginning, to use its Internal Audit Bureau (IAB) and program evaluation group to monitor the implementation of TAGS. The IAB produced a number of reports between October 1994 and May 1996, and their examination gave us a better picture of the nature and seriousness of the difficulties experienced since the April 1994 announcement of the Atlantic groundfish moratorium. These reports contained important observations and recommendations about the operational problems being encountered. Exhibit 16.7 shows some of these observations.

Exhibit 16.7

Internal Audit Observations - Human Resources Development Canada

Internal audit reports	Operational problems
<p>Pre-implementation Review of the Atlantic Groundfish Strategy Computer System (October 1994)</p>	<ul style="list-style-type: none"> • Significant payment errors occurred in TAGS early stages due to system weaknesses.
<p>Operational review of The Atlantic Groundfish Strategy (January 1995)</p>	<ul style="list-style-type: none"> • Program objectives were difficult to achieve because of factors such as delays in implementation, attitudinal barriers and limited incentives to adjustment out of the fishery. • Delays in implementation due to the lack of

	operational plans.
Impact Study Report - Analysis of TAGS Eligibility and Assessment Process (January 1996)	<ul style="list-style-type: none"> • A considerable error rate (Newfoundland 29.85%, other regions 35.48%) was noted in the calculation of eligibility duration for TAGS participants.
Operational review of The Atlantic Groundfish Strategy (February 1996)	<ul style="list-style-type: none"> • Frequent changes have reduced counsellors' credibility and made them more hesitant to respond to policy changes. • The current level of income support payments is reported to be a disincentive to adjustment, because it is higher than the income from a minimum-wage job.

16.47 These reports resulted in some actions, mainly to improve computer systems and review beneficiaries' eligibility. They also highlighted the problems experienced by the regions, which had to adjust to different policies and directives and even had to develop local policies to make up for the lack of general consensus. Consistency of action suffered because of this.

16.48 Without question, the major change the regions had to face was the abandonment of the policy of mandatory active participation by those eligible for assistance. The policy had been aimed at having participants assume responsibility for their situation by encouraging adjustment efforts to increase their chances of finding a job. Financial assistance was tied to active participation on the part of each participant.

16.49 Important regional differences were noted in the application of this policy. The Nova Scotia region, among others, stressed the adjustment program with its participants and strongly encouraged them to join, going so far as to terminate benefits to individuals who refused to comply. Participants could thus receive different treatment, depending on the region where they lived and the local policies in place.

16.50 In November 1995, mandatory active participation of all participants was abandoned and replaced with a prioritization policy, which focussed efforts on the more motivated participants with greater potential for adjustment. Although some counsellors accepted the change, others simply felt betrayed. Counsellors' credibility was at stake — having firmly supported active participation, they now had to change direction. Finally, in August 1996, all adjustment measures were abandoned in order to keep the funds available for income support.

16.51 In summary, many operational difficulties arose during the implementation of TAGS, and HRDC reacted as the situation evolved. Operational constraints changed the way TAGS evolved, sometimes resulting in a re-evaluation of objectives.

16.52 **The government should ensure that any future strategy of this magnitude is launched in a systematic way, even if the intervention is temporary.**

Department's response: While HRDC agrees that, to the extent possible, any strategy of this magnitude should be launched in a co-ordinated way, the audit report does not note that in this particular case, given the changing circumstances that this Department faced, it made every effort within its control to ensure that this was accomplished.

Operational Difficulties in Managing Eligibility

Difficulties in implementing eligibility criteria

16.53 Applying the eligibility criteria required co-operation between Human Resources Development Canada (HRDC) and Fisheries and Oceans Canada. HRDC was responsible for determining whether a worker had enough insurable weeks of work to qualify for TAGS, while Fisheries and Oceans was responsible for confirming workers' attachment to the groundfish industry (that is, determining designated plants and fisher status of workers).

16.54 Eligibility had two components:

- workers' eligibility based on their attachment to the labour force and the groundfish fishery; and
- the duration of the eligibility period, which could vary from two to five years.

16.55 The criteria for determining eligibility and duration of benefits were not easy to apply, because they were not based on the type of information that was available. The fact that eligibility depended on employment over the past five or six years made it essential to ensure from the outset that the necessary data existed and were available.

16.56 HRDC had no means of determining whether workers laid off by a designated plant really had an attachment to the groundfish fishery. It was assumed that anyone who had worked in a designated plant was dependent on the groundfish industry, regardless of the actual work done. This gave all workers from these plants access to the program, including individuals processing other species of fish or doing other types of work.

16.57 Fishers were entitled to benefits as long as it had been established that the volume of their groundfish catches and their income from them met TAGS criteria. In Newfoundland, however, Fisheries and Oceans did not keep records of catches for vessels smaller than 35 feet long. The information needed to assess the fisher status of these fishery workers was not readily available and this resulted in a lack of consistency in the handling of applications.

16.58 Fisheries and Oceans was in charge of assessing the nature of the operations of groundfish processing plants and granting them designated plant status according to previously established criteria. The list of designated plants was drawn up as workers applied to TAGS. There was no complete and official listing available at the time we did our audit. Situations were examined on a case-by-case basis, which allowed certain departures from the criteria on the grounds of extenuating circumstances.

16.59 Some plant owners would have preferred not to be given designated plant status for fear of losing their employees, whereas workers called for it so they could be eligible for TAGS. To be eligible, plant workers had to have been laid off by a designated plant, but it was difficult to distinguish between layoffs caused by the groundfish moratorium and the seasonal layoffs that occur widely in the industry. Layoffs were verified against information from records of employment for the referenced years. In examining the employment records of a number of participants, we found that for the past four or five years the majority of them had been laid off every year in the same way and at the same period.

16.60 The eligibility criteria applied by HRDC required an assessment of labour force attachment for each calendar year. The basic documents used for this were records of employment. However, these documents had not been intended to be used for determining the number of insurable weeks per calendar year — they were normally used to establish entitlement to unemployment insurance benefits based on the work history in the 52 weeks of work preceding the layoff. Therefore, in many cases HRDC could not determine from the record of employment the number of insurable weeks for the year in question.

16.61 In summary, implementation of the eligibility criteria entailed several difficulties. The information available for assessing the eligibility of groundfish workers did not always correspond clearly to TAGS eligibility criteria. Therefore, decisions that might have had an impact on applicants' rights to benefits were made on the basis of incomplete information.

16.62 The government should ensure, before they are implemented, that the eligibility criteria set out in any similar strategy are clear, logical and applicable.

Department's response: HRDC agrees that eligibility criteria set out in a strategy should be clear, logical and applicable before being implemented.

Complex process to determine the eligibility period

16.63 In its report of January 1996, entitled *Impact Study Report — Analysis of TAGS Eligibility and Assessment Process*, the HRDC Internal Audit Bureau focussed on the issue of eligibility and reported very high error rates in the calculation of the duration of eligibility (29.85 percent in the Newfoundland region and 35.48 percent in the Prince Edward Island, Quebec, New Brunswick and Nova Scotia regions). As a result of this report, the Newfoundland, Nova Scotia and Prince Edward Island regions joined forces and set up a special unit known as DARE (Duration Review Assessment Exercise) to review participants' eligibility for TAGS. By April 1997, a total of 12,214 files had been reviewed and an error rate of 29 percent in the calculation of duration had been confirmed.

16.64 It is now the fourth, and perhaps final, year of TAGS. Eligibility is still a subject of interest, because the funds devoted to income support are directly linked to the duration of eligibility. We examined the current situation to determine whether corrective measures have been taken and whether only eligible individuals are receiving or have received benefits.

16.65 We took regional differences in the management of eligibility into account in selecting a sample of files for audit. We selected a sample of 100 files from the participant population in Newfoundland, Nova Scotia and Prince Edward Island (these regions have already systematically reviewed many of their files). Another sample of 100 files was drawn from the Quebec and New Brunswick population, where corrective measures taken differed. The audit consisted of a review of eligibility criteria (benefit entitlement and duration of eligibility) applied by each of the two participating departments. Exhibit 16.8 shows the results of this audit.

Exhibit 16.8

Participants File Review - The Atlantic Groundfish Strategy Eligibility Audit

Regions	Population	Number of files selected	Samples with errors according to criteria of		Percentage of files with errors
			HRDC	DFO	
Newfoundland Nova Scotia Prince Edward Island	35,258	100	6	3	9
Quebec New Brunswick	3,543	100	36	2	38

16.66 The errors detected in the application of HRDC's eligibility criteria primarily involved the duration of benefits and resulted in overpayments and underpayments. The duration of eligibility was not assessed in accordance with operational guidelines. Therefore, payments have been or probably will be made to participants whose eligibility for the period in question has not been correctly assessed. The errors detected in the application of

DFO's eligibility criteria cast doubts on the eligibility of participants, because their attachment to the fishing industry was not proved. However, the number of errors detected was small.

16.67 The results of our audit of the criteria applied by HRDC confirm the value of the work done by the DARE unit in Newfoundland, Nova Scotia and Prince Edward Island. These regions have substantially improved the quality of their eligibility decisions, while the Quebec and New Brunswick regions still have very high error rates. The different regions have not placed the same emphasis on managing eligibility, and participants have therefore not been treated in the same way from one area to another.

16.68 The guidelines were not clear enough to ensure uniform interpretation of the eligibility criteria. Files had to be reviewed several times, and successive notices were sent to participants informing them of changes to their eligibility periods. After more than three years of operation, there are still many inaccuracies in the files.

16.69 Overpayments detected in these reviews were generally due to administrative errors, and the policy was not to claim reimbursements from beneficiaries. Beneficiaries were even given an eight-week grace period before TAGS payments were terminated.

16.70 Major regional differences in the interpretation or application of eligibility criteria were noted in our review. When a participant works in a designated region affected by severe catch failure, the two worst years can be omitted for the purposes of calculating the duration of eligibility under TAGS. The Lower North Shore region used this provision to calculate its clients' benefits, while other areas also affected by severe catch failure did not.

16.71 Verification of fisher status for plant workers who also fished full time during the first years covered by TAGS was not done in the same manner for all participants. In the Quebec region, contrary to Newfoundland, insurable weeks from those years were accepted as groundfish fishing weeks without confirmation of the participant's fisher status.

16.72 Records of employment were not always used properly for determining the number of insurable weeks to establish duration of eligibility. In some cases, staff made decisions without having obtained all the necessary information. Review of employment records and a better analysis of the facts using other documents that were available might, in many cases, have produced a better assessment of the applications.

16.73 In summary, eligibility review was a problem that was recognized from the start and that required considerable effort from staff and management. The different interpretations and approaches to reviewing information resulted in major differences in the assessment of eligibility. Certainly, participants were not informed in a timely way of their duration of eligibility. It is difficult to conduct thorough counselling sessions in the absence of information pertaining to the duration of participants' entitlement to the Strategy. The difficulties encountered during eligibility assessment required far too much effort, time and energy for the process to be considered efficient.

16.74 The Department should:

- **ensure that the review undertaken by the Newfoundland, Nova Scotia and Prince Edward Island regions is completed as soon as possible; and**
- **consider whether the review should be extended to all TAGS participants.**

Department's response: The reassessment of the files for Newfoundland, Nova Scotia and Prince Edward Island will be completed by early fall. HRDC is proceeding to reassess the files from New Brunswick and Quebec to ensure that clients are treated in the same way from one region to another and receive their correct entitlement to TAGS income support benefits.

The Results of Labour Adjustment Will Not Be Known

16.75 Human Resources Development Canada's objective for labour adjustment was to support clients in their adjustment out of the groundfish fishing industry. The Department did set a goal to adjust 50 percent of the clientele eligible for TAGS. Progress toward the target was measured on an ongoing basis. Successful adjustment was measured in terms of the total number of participants who were no longer dependent on TAGS income support because they had become self-sufficient outside the groundfish industry, with or without one of the forms of assistance provided by TAGS.

16.76 A single indicator, adjustment out of the groundfish fishing industry, was used to measure results. A first target of 25,000 participants was established for the global measurement of TAGS adjustment interventions, whether by HRDC or Fisheries and Oceans. A second target of 7,500 participants was set to measure the results of interventions attributable to HRDC, based on the clientele targeted for active participation having been established at 15,000 participants. When it became necessary to transfer funds to income support from other TAGS adjustment measures, the target of 7,500 participants was reduced to 5,500, and ultimately abandoned.

16.77 The Department used the following method to estimate adjustment on an ongoing basis. The number of participants who had made a successful adjustment was calculated on the basis of data from the TAGS payment system, and included participants who had received less than 25 percent of the benefits payable during a 12-week period. For those participants who had adjusted out as a result of HRDC interventions such as the Employment Bonus, Wage Subsidy, Self-Employment Assistance and Job Opportunities, the adjusted-out figure was discounted by 35 percent. This adjustment was based on past success rates in similar programs achieved in the regions affected by TAGS.

16.78 The reliability of this method has not been established. A participant survey would be needed to determine the confidence level or to review the adjustment factor. The Department recognizes that follow-ups or evaluations are necessary, but there is no plan to conduct any.

16.79 The Department had to evaluate a five-year program that was recognized as having by necessity been developed too quickly. Two types of evaluation had been planned. The first, to be conducted during the program's development and implementation, was to recommend improvements to the program. The Department requested and obtained the appropriate evaluation studies and a first evaluation was completed. The studies for this evaluation dealt with issues that were appropriate and useful for management purposes. The second type of evaluation was to have been conducted once the program had stabilized, and was intended to evaluate the results and effects of the program. However, because of the way TAGS developed, evaluation efforts were abandoned in March 1997. The second type of evaluation will not be done and many questions will remain unanswered.

16.80 Important questions that the second evaluation would have raised included: "Does income support encourage or limit effective adjustment for TAGS clients? To what extent has TAGS contributed to an orderly transition to employment outside the fisheries sector?" With the abandonment of evaluation efforts, there will be no clear answers to these questions. It will not be possible to draw useful lessons for future programs. Information to account for the money spent will not be available, and it will not be possible to determine the extent to which TAGS objectives were achieved. We are concerned that the information gathered in the initial phase and the lessons learned might be lost and the results remain unknown.

16.81 The Government of Canada recently announced that it would make a temporary change to the Employment Insurance Regulations allowing TAGS benefits to be considered as labour force attachment for the purpose of qualifying for employment insurance benefits. It also announced its commitment to undertaking a review of longer-term post-TAGS issues in the fall and to consult with relevant provinces and industry stakeholders.

16.82 The Department should continue its efforts to evaluate the TAGS labour adjustment component and report on the results, thus contributing to an enlightened discussion of all programs of this type that may be considered in the future.

Department's response: HRDC agrees in principle that efforts to evaluate the TAGS labour adjustment component and to report on the results should be continued. However, as the labour adjustment component of TAGS is no longer available, other than that of income support, any evaluation conducted of TAGS would have to be done as part of HRDC's regular evaluation of programs. The Department has already learned useful lessons from TAGS and will continue to access results through its regular activities.

An Accountability Framework Unsuitable to the Strategy

16.83 The Atlantic Groundfish Strategy was the fourth program to target problems associated with the decline of Atlantic groundfish (see Chapter 14, Exhibit 14.12). Two of the three programs that preceded it also included components aimed at industry capacity reduction and labour adjustment. Therefore, we expected to find that an effective accountability structure had been put in place for TAGS.

16.84 Before TAGS came into force, the Treasury Board informed Fisheries and Oceans and Human Resources Development Canada that it was holding them equally responsible for managing TAGS within the financial envelope provided. It mandated HRDC to set up a control system to ensure that costs did not exceed the envelope. HRDC assumed a lead role and devoted time and efforts to ensure that the financial constraint imposed on TAGS was respected.

16.85 The responsibilities of the organizations charged with developing and implementing TAGS were not clearly defined and agreed upon in a memorandum of understanding. There was no formal mechanism for co-ordinating activities. Co-ordinating was important and the need for extensive mechanisms to do so should have been envisaged. Overall, co-ordination was informal. Human Resources Development Canada recognized that TAGS required joint administration on the part of the organizations concerned, and tried to provide co-ordination by inviting its federal partners to participate in its TAGS management team. However, its authority to do so was not recognized and its efforts sometimes irritated its partners.

16.86 While the implementation of the TAGS components generally corresponded to the responsibilities of the participating departments, a number of initiatives were complementary and required co-operation and an exchange of information. Examples are the determination of TAGS eligibility and the identification of a core group of fishers. At the regional level, there were certain memorandums of understanding between HRDC and Fisheries and Oceans for projects or the exchange of information.

16.87 According to the guiding principles approved for it, TAGS was to offer an integrated approach to capacity reduction and the adjustment of individuals and communities affected by the moratorium. It was essential that management and accountability be integrated as well.

16.88 However, there was no integrated strategic plan to identify and schedule the activities of the organizations responsible for implementing TAGS or to determine the performance indicators to be used, monitored and reported on periodically. Although certain activities were conducted jointly, each organization conducted its own audit and evaluation activities and the results were not consolidated.

16.89 Given that co-operation among the four organizations responsible for implementing TAGS was so important to its success, we expected that Parliament would receive integrated information to account for the use of funds. However, no joint report was issued by the four organizations.

16.90 There is information on some TAGS components in the Part III Estimates of Fisheries and Oceans and of Human Resources Development Canada. Both departments also testified several times before the Standing Committee on Fisheries and Oceans on the implementation and progress of TAGS. However, none of this made it possible to determine progress toward the TAGS objective of restructuring the fishing industry to make it economically viable and environmentally sustainable.

16.91 In summary, our review of the accountability framework for TAGS revealed major weaknesses that had an impact on value for money. Great care in planning a strategy of this magnitude was needed to ensure that its objectives were reached. Because a number of stakeholders were involved and their activities were often joint or complementary, the different components needed to be carefully co-ordinated. The forecasts used to distribute program funds among the stakeholders were based on a strategy different from the one ultimately approved. Despite numerous consultations, the stakeholders did not necessarily have the same timetable. The co-ordination framework was inadequate.

16.92 **Should another strategy be adopted that involves a number of federal organizations, the government should consider instituting formal measures to ensure accountability for the strategy as a whole.**

Department's response: HRDC agrees that should another strategy be adopted that involves a number of federal organizations, formal measures to ensure accountability for the strategy as a whole should be in place. The accountability framework now in place for Employment Insurance Part II reflects HRDC's commitment to this principle.

Conclusion

16.93 After numerous efforts and successive programs and activities to support the population affected by moratoriums and reduced groundfish quotas, the necessity and viability of such actions need to be examined.

16.94 At a time of dramatic change in the Atlantic fishing industry, TAGS was designed to carry on the previous efforts to support workers in the industry. The income support and labour adjustment programs supporting TAGS changed continually as the various elements of TAGS fell into place. Uncertainty remains about whether TAGS is primarily an income support program or an industry restructuring program. Although active labour adjustment measures had been designed to support industry restructuring efforts, the co-ordination and scheduling of TAGS activities did not make it possible to maintain them. The abandonment of all labour adjustment measures in August 1996 has left only the income support component still in place.

16.95 The frequent changes to TAGS made it difficult to implement the labour adjustment measures. These changes created considerable uncertainty among participants and stakeholders. The operational guidelines underwent numerous changes and clarifications. Management of eligibility was particularly affected, resulting in many situations where income support was not assigned fairly and equitably to all participants.

16.96 Progress toward the target for labour adjustment will not be measured by HRDC. Although an evaluation aimed at improving the program was carried out, the decision to discontinue the evaluation effort means that important questions will remain unanswered, and it will not be possible to learn all the lessons that might have been drawn from the experience or to account for the results.

16.97 The absence of an appropriate accountability framework for this type of initiative meant that there was no assurance of obtaining value for money. Efforts were directed at income support for individuals affected by the groundfish moratorium; groundfish harvesting capacity was not significantly reduced through TAGS measures. Active labour adjustment measures were halted, and whether they actually contributed to reducing the number of

persons dependent on the industry is not known. Excess fishing capacity remains, and poses a major risk to the sustainability of the fishing industry.

16.98 Given that the federal government proposes to review the longer-term issues arising from the elimination of TAGS in May 1998, we urge it to examine carefully the consequences and impacts of the decisions made under TAGS in order to benefit from the valuable lessons that can be learned.

About the Audit

Objective

The objectives of this audit were to determine whether, for the purposes of The Atlantic Groundfish Strategy:

- the income support and labour adjustment programs administered by Human Resources Development Canada contributed to the economical and efficient achievement of objectives;
- an effective accountability framework was established.

Scope

Our audit covered the measures established by Fisheries and Oceans and Human Resources Development Canada to account for the delivery of The Atlantic Groundfish Strategy. The labour adjustment component administered by Human Resources Development Canada was examined in relation to TAGS objectives.

We reviewed the planning and implementation documents describing the different stages in the evolution of TAGS. We examined how HRDC performed its internal audit and evaluation duties, in particular the recent work on TAGS. Participant eligibility and entitlement to benefits were covered by reviewing eligibility criteria applied to a sample of TAGS participant files.

The management of active labour adjustment measures was not audited because, at the time of our audit, they had been discontinued. Our audit did not deal with the use of funds allocated to the Atlantic Canada Opportunities Agency and the Federal Bureau of Regional Development - Quebec.

Criteria

The criteria used in our audit were the following:

- The planning and implementation of income support and labour adjustment programs administered by HRDC should reflect government objectives and be designed to carry out the objectives of The Atlantic Groundfish Strategy.
- The results of HRDC activities related to TAGS should be measured and known.
- The Department should provide Parliament with reliable, relevant, and comprehensible information.
- The Department should ensure that all those and only those who are eligible receive income support.
- An accountability structure should be put in place for The Atlantic Groundfish Strategy.

Audit Team

Andrée Bélair
Kathleen Hobbs
Sylvie Paré
Michael Ryan

For information, please contact Louis Lalonde, the responsible auditor.

Chapter 17

Human Resources Development Canada

A Critical Transition toward Results–Based
Management

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Human Resources Development Canada

A Critical Transition toward Results–Based Management

Assistant Auditor General: David Rattray
Responsible Auditor: Louis Lalonde

Main Points

17.1 Human Resources Development Canada has begun a transition toward results–based management. To this end, it has instituted a number of initiatives, including the publication of its *Results–Based Accountability Framework*, consultation with employees, and establishment of performance measures for major activities. The Department has also extended the application of these performance measures to activities carried out jointly with its partners. Overall, the roles and responsibilities of the partners are well defined. Also, the new Labour Market Development Agreements generally include the elements that are essential to good accountability among partners.

17.2 Certain steps remain to be taken to complete this transition. The Department needs to strike a suitable balance among the effectiveness, cost and quality of its services; at present, it does not analyze costs along with key performance indicators. It also needs to link performance to the consequences of having met or not met expectations.

17.3 The support of the employees working in the Human Resource Centres of Canada is essential if the Department is to successfully implement the Framework. The credibility of data on certain programs needs to be resolved within a reasonable timeframe. Employees need to have confidence in the reliability of the information, or the entire initiative may be jeopardized.

17.4 The information that Parliament receives on actual results compared with stated objectives is incomplete. We believe that, given the importance and the special nature of the Employment Insurance Account, it would be beneficial for Parliament if information were all in one place. There is no distinct report containing financial information on performance. Such a report could include, among other things, performance information, results achieved and actuarial analyses, which at present are not tabled in Parliament. Tabled actuarial analyses would improve the transparency and the availability of the data necessary for establishing an adequate reserve in the Account.

17.5 Our audit of two activities, management of accounts receivable and protection of program integrity, confirmed that progress has been made in results–based management. The Department has made major efforts since 1994 to integrate and harmonize the management of accounts receivable for all its programs. However, the quality of the portfolio of accounts receivable has deteriorated over the last five years. The performance of accounts receivable could be better measured, targeted and analyzed in order to assess the cost effectiveness of the Department's collection activities.

17.6 In activities for the protection of program integrity, results–based management is most advanced in the Employment Insurance Program. Since 1992, the Investigation and Control Directorate has been using information on results to negotiate resource levels and to set the national savings expectation. However, the other activities for the protection of public funds could be better measured and targeted in order to manage for results.

Introduction

The Department is going through a transition

17.7 Recent years have seen a trend, both in the federal government and elsewhere, toward increased management accountability. A number of related initiatives have been undertaken at the federal level: Public Service 2000, Program Review, increased flexibility in human resource management, the requirement for Business Plans, and an emphasis on managing for results.

17.8 Human Resources Development Canada (HRDC) provides services in various areas such as employment insurance, income security and student loans. In 1996-97 the Department made disbursements totalling \$56 billion, including payments for the Employment Insurance Account and the Canada Pension Plan. Some seven million Canadians received benefits or other forms of assistance.

17.9 The Department has begun a transition toward results-based management, whose underlying philosophy involves a change from the traditional emphasis on process to one that focusses on results. In practical terms, this means that managers will be more and more responsible because of increased authority and more flexible rules. This is expected to produce more effective accountability with an emphasis on results achieved.

17.10 To complete this transition, HRDC is working on a number of fronts simultaneously: the Service Delivery Network, the Income Security Programs Redesign Project, the *Employment Insurance Act*, the review of the *Canada Labour Code*, agreements on alternative service delivery, and Labour Market Development Agreements with the provinces.

17.11 In October 1996 the Department published its *Results-Based Accountability Framework*, setting out the main elements of its new management philosophy. Exhibit 17.1 provides a schematic summary of one of the major elements of the Framework — results-based management. The Department has also published a document entitled *Redefining Our Roles and Responsibilities in Support of Departmental Priorities*, which defines in general terms the roles and responsibilities of the Department's Corporate Service. The document *Quality Services Journey* deals with the Department's approach to the government's Quality Service initiative. All of these documents are interrelated.

Exhibit 17.1

(This exhibit is not available, see the Report)

Focus of the audit

17.12 The objective of our audit was to examine one of the major elements of the *Results-Based Accountability Framework*, namely results-based management. Since HRDC has an important place in the federal government, we thought it would be appropriate to examine the progress it has made and the steps it still needs to take. We looked at progress in two specific activities: management of accounts receivable and protection of program integrity. Findings on these two activities are presented in the two cases that begin at paragraph 17.67.

17.13 We also examined the information the Department provides to Parliament, including information on results. For this, we selected the Department's two largest programs: the Canada Pension Plan and the Employment Insurance Account. Further details on the audit objectives, scope and criteria are presented at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

Progress toward Results-Based Management

Employee support and senior management participation are essential

17.14 Implementing results-based management is always a major challenge, since it involves changing a complex set of elements and dimensions that underlie existing management structures. It is important to first clearly define the nature of the change to be made and to specify its main parameters. The Department did this when it published its *Results-Based Accountability Framework* in October 1996, which describes the planned changes to the Department's management approach. Although this framework is recent, we were able to identify a certain amount of progress achieved in the past year.

17.15 A precondition for the success of an initiative aimed at changing a management approach is that it be clearly formulated and accurately reflect the Department's mission and operating principles. We found that the Framework does both. In examining the strategic planning documents (HRDC Business Plan Summary, Estimates, Quality Service Strategy), we noted that they are interrelated and are consistent in terms of their objectives and the methods to achieve them.

17.16 Another requirement for successfully implementing a new management framework is employee support. The Framework stresses the importance of consulting with employees, and the Department is making efforts to do so. It sent a questionnaire to employees in certain Human Resource Centres of Canada and held a series of discussion groups in five regions. These consultations revealed that employees were reticent about some aspects of the initiative. Given the importance of securing their participation, the Department is continuing discussions to address employees' concerns.

17.17 The active participation of senior management is also a decisive factor in the success of results-based management. We noted that HRDC established a steering committee on quality of service, made up of assistant deputy ministers, which has met regularly since September 1995 to discuss progress in implementing the service quality and results-based management initiatives. It has made various decisions aimed at ensuring that the pace of progress is satisfactory. The Department's Management Board has also monitored progress and discussed the implementation of the new management approach and the related performance reports that have been issued.

17.18 The Department has increased its delegation of authority and has shown more flexibility at the local level. It has begun implementing the Service Delivery Network, aimed at making it easier for clients to access various HRDC services while achieving savings in the use of resources. One of the objectives of this initiative is to increase the authority, empowerment and accountability of line staff. Income Security Programs is also introducing a new client service delivery network, which will broaden the responsibilities of employees at the local level.

17.19 The Department publishes reports on its efforts to reduce obstacles, that is, practices that burden and slow down management unnecessarily and deprive employees of the needed flexibility to resolve problems quickly and effectively. The Department points to a number of administrative changes that simplify the approval process and increase the authority delegated to the local level.

Roles and responsibilities of partners are generally well defined

17.20 In the context of results-based management, with flexible rules and more delegated authority, the responsibilities of each of the stakeholders need to be set out clearly. The parties need to have a clear idea of what they are being held responsible for and what results they are expected to achieve. We examined the Employment

Insurance Account and the Canada Pension Plan (CPP), whose administration is the responsibility of a number of federal partners, to determine whether the roles and responsibilities of each are clearly defined.

17.21 In our opinion, the roles and responsibilities of the various federal partners who administer the Employment Insurance program (see Exhibit 17.2) are, overall, well defined. There is a Memorandum of Understanding between HRDC and Revenue Canada setting out their respective roles and responsibilities, which was revised in June 1994. While the role of the Canada Employment Insurance Commission is clear, it is somewhat limited and should not be compared with the traditional role of a board of directors.

Exhibit 17.2

(This exhibit is not available, see the Report)

17.22 The CPP is also administered and operated by various federal partners (see Exhibit 17.3), making it more difficult to plan and manage the program and to define the respective responsibilities of the various departments. Memorandums of understanding have been negotiated and signed by the various parties involved, clarifying the roles and responsibilities of each. We nevertheless have some concerns about some aspects of the Chief Actuary's role and responsibilities.

Exhibit 17.3

(This exhibit is not available, see the Report)

17.23 In accordance with the CPP Act, the Chief Actuary of the Office of the Superintendent of Financial Institutions prepares actuarial reports on the projected status of the CPP Account for the next 75 years. These reports are transmitted to the Minister of Finance who tables them before Parliament. In connection with our audit of CPP Disability benefits last year, we examined the assumptions made for financial forecasts by the Chief Actuary in his *Fifteenth Actuarial Report as at December 31, 1993* (the most recent one published) and found them to be adequate and appropriate. However, we believe the Chief Actuary's role and responsibilities in relation to the provinces need to be clarified.

17.24 The federal and provincial governments, as partners in the decision-making process, can call upon the Chief Actuary's services to analyze the potential impact of any proposed changes to the Plan. We expected that his analyses would be available to all partners on a timely basis.

17.25 The Chief Actuary informs the Department of Finance of any requests he receives from the provinces, without disclosing their content. He has assured us that the results of his analyses go directly to the requesting province and that all results remain confidential. The Chief Actuary does not report to the provinces similar requests by the federal government. We believe that all analyses produced should be made available to all the partners. It is important that the Chief Actuary's role and responsibilities be clarified to ensure that all partners have access to the same information. This would add transparency to the decision-making process.

A system for measuring results has been put in place

17.26 The central element of results-based management is the measurement of results, which constitutes a systematic approach for attesting to the Department's performance. Program managers have established a maximum of three key performance indicators for which Human Resource Centres of Canada will be responsible, and which will be used for measuring and reporting results to senior management and to Parliament. Exhibit 17.4 summarizes the key indicators selected for each business line. Secondary indicators of performance are used in monitoring activities.

Exhibit 17.4

(This exhibit is not available, see the Report)

17.27 By concentrating on a limited number of performance indicators, the Department is better able to ensure that managers and employees focus their attention and efforts on priority aspects of performance. HRDC produces regular performance reports, which are the subject of discussion and follow-up by departmental senior management. It has also begun setting up a Corporate Management System (CMS), an automated system to integrate and streamline the processing of information. This system will make it easier to produce the performance reports that are essential to results-based management.

17.28 In a context of increased co-operation among various levels of government, HRDC has not limited this new approach to its own activities but has extended it to joint activities with its partners. For example, the Department has signed Labour Market Development Agreements with a number of provinces. These agreements stem from the federal proposal to establish a new partnership with provincial and territorial governments in connection with labour market activities, based on the new *Employment Insurance Act*. These new arrangements aim to help put unemployed Canadians back to work, to encourage innovation and adoption of tested practices, and to strengthen federal-provincial-territorial partnerships.

17.29 The agreements generally include the elements essential to good accountability between partners. More specifically, they specify indicators for measuring results as well as targets for the results that are expected. The Department will use these same indicators to fulfil its obligations for monitoring and assessment. The indicators are: priority access for Employment Insurance claimants; the number of Employment Insurance clients who have returned to work; and savings in the Employment Insurance Account achieved as a result of reduced dependency on Employment Insurance benefits.

17.30 However, it is important that this performance information not be simply filed away but be put to good use by program managers. Hence, the Department's Investigation and Control Directorate, whose objective is to prevent, detect and deter fraud and abuse in the Employment Insurance Account, has decided to use the total savings generated by its activities as a key performance indicator. Adoption of this indicator has had a marked impact on the nature and scope of investigation and control activities, by encouraging managers to seek an appropriate balance between prevention and detection. The indicator has become an element used to determine the level of resources to be allocated to the program and to facilitate accountability. More details on this subject can be found in Chapter 11, Moving toward Managing for Results.

Certain Steps Remain to Achieve Stated Objectives

Balance in indicators is important

17.31 The Department has decided to focus on a few key indicators so that senior management and employees can concentrate on the strategic results that are expected, instead of being overwhelmed by an excessive amount of information. Focussing on a few indicators is thus a positive step.

17.32 An important factor in choosing key indicators is the reasonable expectations of clients since, as the Framework notes, they are "best equipped to comment on what constitutes good service". Thus, Employment Insurance based its choice of some indicators on client surveys that showed which aspects of service were most important to clients. Income Security Programs also plans to eventually include client satisfaction in its indicators.

17.33 The choice of the key indicators is of paramount importance, as they will serve as the guideposts for determining the quality of program and service management. Choosing performance indicators entails some risk, since the focus on highly specific indicators can affect other aspects of performance not considered as high a priority. Exhibit 17.4 shows the key performance measures chosen by the Department, based primarily on performance issues. For example, issues of telephone centre performance are much more pronounced in Income Security Programs than in Employment Insurance. Therefore, the percentage of telephone calls answered is considered a key indicator for Income Security, but only a secondary indicator for Employment Insurance.

17.34 The Framework specifies, “Results measurement should strike an appropriate balance between efficiency, effectiveness, cost and quality of service.” The Department’s key indicators do not take cost and efficiency into account; only the secondary indicators do so. However, unlike key indicators, secondary indicators are not targeted in all cases and are not subject to reporting to Parliament.

17.35 Costs and results are closely linked. For example, it is important to know how improving service quality impacts on costs. Although the Department has established a number of measures to improve service, it does not always have adequate information to assess the link between the effectiveness and the cost of services. Since its operating costs are expected to be reduced in the coming years (see Exhibit 17.5), the Department will need to consider costs in analyzing the results it achieves.

Exhibit 17.5

(This exhibit is not available, see the Report)

17.36 The Department has indicated that it intends to review and refine its performance indicators on an ongoing basis. Indeed, as program performance issues evolve, so do the performance indicators. A key indicator may become a secondary indicator and vice versa. The Department is currently revisiting its key indicators for 1998-99. While some adjustments to indicators may be necessary to reflect what has been learned, it is important that they be used for a long enough period to identify trends in order to determine whether performance is improving or deteriorating.

17.37 Furthermore, as the Framework indicates, an essential element of results-based management is the evaluation of overall program effectiveness. Instead, however, the current indicators stress day-to-day management and program outputs. Program results must also deal with outcomes, that is, the effects and impacts of those outputs. This information is generally produced in connection with periodic program evaluations by the Department.

17.38 For example, the Evaluation and Data Development Branch monitors the impacts of the new Employment Insurance legislation. Its activities will include conducting a survey on this program’s impact on individuals, performing a qualitative analysis at the community level, and asking specialists to perform impact analyses. This information needs to be examined together with the key indicators in order to report on performance and obtain an overall picture of the results achieved.

Further progress is needed to ensure credibility of data

17.39 A useful system for measuring results is a key factor in successfully implementing an initiative of this kind. The Treasury Board echoed this view in approving the Department’s new Planning, Reporting and Accountability Structure on the understanding that it would continue to work “on improving its performance measurement strategies and key results”. The data used to measure the achievement of results thus need to be credible. Indeed, both senior management, which uses the data for decision making, and employees, who rely on the data as useful feedback on their performance, must be able to trust the information or it is likely that the data will not be used, and the entire initiative may be jeopardized.

17.40 Parliament is also a major user of these data. Information on results allows the Minister to answer to Parliament for the effectiveness of HRDC programs. However, as we note in paragraphs 17.47 to 17.66, Parliament currently does not receive all the information it requires. It is important that information provided to Parliament be credible, so that Parliament can use it in its decisions to authorize funding.

17.41 An audit by the Department’s Internal Audit Bureau revealed certain problems among employees with the credibility of some program data. In the case of the Labour Program, the negative perception could be because the indicators are relatively new. For Income Security Programs, preliminary data are gathered manually, which increases the risk of reduced overall reliability. The Department contends that with the ISP Program Redesign

currently under way, its data collection programs will eventually be automated. For the Human Resources Investment Fund, a study by the Evaluation and Data Development Branch is seeking to resolve some of the methodological problems associated with measuring the additional savings generated by the program.

17.42 For a number of years now, the Employment Insurance Program has had a system for the capture, analysis and reporting of performance data. The internal audit report notes that, while improvements are possible, all the features of an effective and useful system are present. Employees are therefore not as concerned about the credibility of data from the Employment Insurance systems.

17.43 Nonetheless, in various consultations held by the Department, employees have expressed skepticism about the credibility of data. This situation constitutes a major challenge for the Department, since the support of employees, especially in the rank and file and at the local level, is a crucial element that will determine the Framework's success. The internal audit also noted that the monitoring and analysis of performance information has largely been delegated to regional offices and Human Resource Centres of Canada, which may not have the resources and skills needed for the task.

17.44 It will be difficult for employees to accept the need for management on the basis of performance targets if they do not feel that the targets are based on reliable data. The internal audit report also notes the need to link performance to the consequences of having met or not met expectations as a step that the Department still has to take. A connection also needs to be made between resource allocation and expected results. It is clear that the Department needs to obtain more solid support from employees if it is to take these steps successfully.

17.45 Since acceptance at the local level is vital, the Department needs to resolve, within a reasonable timeframe, the ambiguity surrounding data credibility. Certain quality controls could strengthen confidence in the data and provide a reasonable level of assurance that they are reliable. In its report on this subject, the Internal Audit Bureau stressed the need to test data to ensure that they are relevant and, above all, reliable.

17.46 To build on the progress made and to maintain the pace of its implementation of results-based management, the Department should:

- **ensure that the choice of key performance indicators takes costs into account;**
- **ensure the quality of performance data to increase their credibility among employees and managers who use the data; and**
- **ensure that the selected key indicators remain in place long enough for performance to be assessed over time.**

Department's response: The Department takes costs into account when establishing primary indicators and when setting targets for them. Generally, primary indicators are designed to report on results, while costs are tracked through secondary indicators. The Department remains committed to maintain its selected indicators so that performance can be assessed over time.

We are developing a mechanism to maintain data integrity that will allow service delivery partners to transmit data directly to HRDC's systems. Some of the data integrity problems are due to systems problems and data capture methods, which are in the process of being fixed.

Information to Parliament Is Incomplete

17.47 The *Results-Based Accountability Framework* defines the fundamental elements that will allow HRDC to be accountable to employees, partners, clients and parliamentarians for the management of its resources and for the results it achieves.

17.48 We examined the information on results communicated to Parliament in HRDC's Estimates Part III, its Business Plan Summary and the Annual Report of the Canada Pension Plan.

17.49 The 1997-98 Estimates and the 1996-97 Business Plan Summary do not yet present all the results achieved in relation to stated objectives for the key performance indicators. It is still too soon to provide this type of information. We encourage the Department to communicate regularly to its employees, partners, clients and Parliament the results achieved as soon as the information is available and credible.

The Annual Report of the Canada Pension Plan is moving in the right direction

17.50 The Annual Report of the Canada Pension Plan (CPP) is an especially important accountability document, since the plan is managed jointly with the provinces and responsibilities are shared among various federal departments. HRDC is responsible for administration of the Canada Pension Plan (Act), except for collecting contributions, which is the responsibility of the Minister of National Revenue. The Minister of Finance and the provincial counterparts are responsible for setting premium rates for the Plan.

17.51 The annual report of the CPP for 1995-96 provides an excellent overview of the responsibilities of the various departments involved. It also presents a good summary of the services offered, the clientele served and the benefits paid. This constitutes a major improvement over previous years.

17.52 In order to make the report complete, we suggest that it include the following elements:

- a discussion of the mandate, objectives and strategies adopted by management, and an explanation of how the activities and services provided support the objectives and the mandate of the CPP;
- a comparison of actual performance with targets or objectives, to complete the information on achievement of results, when systems allow;
- adequate future-oriented information, for example, the impact of the aging of the population;
- information on the interrelationship between economic and social issues; and
- complete and relevant information on the major activities related to disability benefits.

17.53 **The Department should ensure that the Annual Report of the Canada Pension Plan clearly reflects the mandate, objectives and strategies and includes more future-oriented information and, as soon as it becomes available, more complete information on performance in relation to expectations.**

Department's response: We agree with the recommendation and will strive to incorporate any relevant strategies, information on future direction of the Canada Pension Plan (CPP), and information on the performance of the CPP against the expected results, as it becomes available. It should also be noted that information on the future direction and projected financial status of the CPP is currently already available in other reporting vehicles, namely Part III of the Estimates and the CPP Actuarial Report.

There is no distinct report on the Employment Insurance Account

17.54 There is no distinct report on the Employment Insurance Account (EIA). Information on the budget and on performance is provided in the Department's Estimates. The audited financial statements are presented in Volume I of the Public Accounts.

17.55 Neither the *Department of Human Resources Development Act* nor the *Employment Insurance Act* require that a separate report be prepared and submitted to Parliament, apart from a report on the impact of changes brought about by the new legislation, which must be submitted no later than December 31 for the next four years.

17.56 We are concerned that financial information on performance is diffused and that it is difficult to know the results achieved in the operations of the EIA compared with the budget and the Business Plan Summary. Moreover, there is no performance information on the collection of premiums, which is the responsibility of Revenue Canada.

17.57 We believe that the importance and the special nature of the Employment Insurance Account, which is wholly funded by employers and workers, warrants a distinct report that would bring information together in one place, including information on performance, results and the audited financial statements. This report could be linked to the new Performance Report that the Department is to table to Parliament in the fall of each year.

17.58 **The Department should produce, on a timely basis, a report providing complete, relevant and timely information on the major activities related to the Employment Insurance Account in order to report on the results achieved and on the management of resources allocated.**

Department's response: The requirement to produce an annual report on the Employment Insurance Account (EIA) was eliminated by Parliament through legislation. Information on the major activities related to the EIA reporting on the results achieved and on the management of resources allocated can be found in the Departmental Performance Report and the Report on Plans and Priorities. However, HRDC will explore the possibility of producing a complete report on the Account.

Actuarial analyses of the Employment Insurance Account are not tabled in Parliament

17.59 Under the *Employment Insurance Act*, "the Commission shall, with the approval of the Governor in Council on the recommendation of the Minister [of HRD] and the Minister of Finance, set the premium rate for each year at a rate that the Commission considers will, to the extent possible... ensure that there will be enough revenue over a business cycle to pay the amounts authorized to be charged to the [EIA] and ... maintain relatively stable rate levels throughout the business cycle." This is a change from the old *Unemployment Insurance Act*, and it allows the Account to establish a reserve to finance deficits during a business cycle without having to increase the premium rate.

17.60 In our 1994 Study of Key Federal Social Programs, we noted that a reasonable reserve in the Unemployment Insurance Account would be desirable. It would alleviate the need for borrowing, reduce interest costs thereof, and provide some relative stability in the premium rate as well as protection against unexpected cost increases. At that time, we raised questions we thought deserved consideration, such as what constitutes a reasonable reserve and how much time is required to build it.

17.61 We note that the Commission has not yet come to a decision on what constitutes an adequate reserve and how much time is required to build it to ensure that there will be enough revenue over a business cycle and to maintain relatively stable rate levels throughout the business cycle.

17.62 On the basis of the report of the Chief Actuary of HRDC, the Commission set the 1997 premium rate for workers at \$2.90 for each \$100 of insurable earnings (the 1996 rate was \$2.95). A reserve of some \$12 billion at the

end of 1997 is forecast, representing approximately 1.2 times the forecast average annual amount of regular benefits.

17.63 In this internal report, the Chief Actuary states:

...the amount of reserves needed to ensure 'relative premium rate stability' is not a fixed amount. Reserves will be at a low point towards the end of recessions, and would be rebuilt during an economic recovery. There does not seem to be any need for exceeding an absolute level of about \$15 billion. However, stabilization also involves dealing with the risks of setting up the reserve too quickly or at too high a level — perhaps starting when they would reach or exceed \$10 billion.

17.64 However, the actuarial analyses, so important in setting premium rates for the EIA, are not made public as they are for the Canada Pension Plan. Making the actuarial analyses public would improve the transparency and availability of the data required to know the potential impacts of the options put forward.

17.65 Since the actuarial analyses are not public information, the setting of premium rates lacks transparency and may be susceptible to influence by factors unrelated to the objectives set out in the Act, namely to ensure that there will be enough revenue and to maintain relatively stable rate levels. Indeed, setting premium rates could be influenced by the fact that any annual surplus or deficit in the Account has an impact on the government's deficit. For example, if the Account had an annual surplus of \$5 billion, the federal deficit for that year would be reduced by the same amount.

17.66 The Department should ensure that the actuarial analyses necessary for setting the premium rate of the Employment Insurance Account, including the level of a reasonable reserve and the time required to build it, are tabled in Parliament to make the setting of premium rates more transparent.

Department's response: All the relevant information with respect to the EI Account is already in the public domain such as in the government's annual economic update, the Budget, Main Estimates and the background material regularly provided with the HRDC press release announcing the annual premium rate decision.

Case 1 — Management of Accounts Receivable

17.67 The Department manages one of the largest portfolios of accounts receivable in the government, essentially from the Student Loans, Employment Insurance and Income Security programs. Accounts receivable have grown from \$1.6 billion to \$2.6 billion over the last five years, an increase of \$1 billion or 65 percent (see Exhibit 17.6). Accounts receivable for the Student Loans and Employment Insurance programs represent, respectively, 73 percent and 23 percent of the total portfolio. Collection of accounts receivable represents a major source of funding. For example, for the Employment Insurance Account's portfolio of accounts receivable, amounts totalling about \$340 million recovered for the 12-month period ended 31 March 1997 represented close to 25 percent of administrative expenditures.

Exhibit 17.6

(This exhibit is not available, see the Report)

17.68 To better assess the progress made in the transition toward results-based management, we examined the management of accounts receivable, which is shared between program staff and Financial and Administrative Services staff. Where management of an activity is shared, accountability for results is even more necessary to focus in the same strategic directions the efforts of those involved.

17.69 The active and inactive accounts receivable in the Employment Insurance Program and the Income Security Programs stem essentially from overpayments that have been detected and recorded as amounts to be

recovered. Active accounts receivable are collected by program staff from benefit payments to beneficiaries before they are issued. Inactive accounts receivable are those owed by beneficiaries who no longer receive benefit payments; they are recovered by specialized collection agents of the 12 collection centres administered by Financial and Administrative Services. The number of employees working in the collection centres increased from 251 to 310 between 1992-93 and 1996-97.

17.70 The Department also collects from students who have failed to meet their loan repayment obligations. Responsibility for collecting newly defaulted student loans was transferred to financial institutions in August 1995; hence, the Department's current portfolio of student loans will decrease in the future. At present, the Department sends the defaulted student loans portfolio to collection agencies.

Major efforts are being made to improve performance

17.71 In 1994, senior management decided to integrate and harmonize the management of accounts receivable of all HRDC programs to make collection activities more efficient and effective. In June 1995, HRDC's Priority Steering Committee ratified a strategy and made the following three recommendations:

- develop, communicate and implement a single departmental policy on accounts receivable and collection;
- implement a single Departmental Accounts Receivable System; and
- implement various collection pilot projects to facilitate a decision on the collection strategy and the optimal organizational structure to be adopted.

17.72 The aims of the strategy include reducing overlap in collection activities between programs and Financial and Administrative Services, improving collection practices and increasing performance results. Exhibit 17.7 shows the major elements of the strategy and the progress made in implementing it.

Exhibit 17.7

Progress Achieved in Implementing the Accounts Receivable Strategy

Major elements of the strategy	Progress achieved
Single policy	<ul style="list-style-type: none"> • Ongoing consultation between collection unit and programs staff for raising and resolving policy issues of mutual interest. • Review of the relevance of hardship in the collection process under way. • Review of policies on write-off of debts and internal set-off under way.
Departmental Accounts Receivable System (DARS)	<ul style="list-style-type: none"> • Development of the DARS and transfer of accounts from the Canada Pension Plan (CPP). A transition plan was developed to include all the Department's other accounts receivable. • Pilot project for a corporate letter system. • Development of an interest calculation function.
Use of private collection agencies	<ul style="list-style-type: none"> • Regional working group set up in October 1996. • Initial identification and analysis of issues completed for accounts receivable of the Employment Insurance Program only. Evaluation of selection criteria has not been finalized.
Responsibilities for collection	<ul style="list-style-type: none"> • Management of collection activities for inactive accounts transferred from the CPP to Financial and Administrative Services (FAS). • Monitoring of the activities of private collection agencies partially transferred to FAS.
Sharing of information between programs	<ul style="list-style-type: none"> • Examination of policy and legislative barriers between programs by an interdepartmental committee. An action plan is being prepared.

Collection tools	<ul style="list-style-type: none"> • Implementation of a monthly account statement system in two regions. • Pilot project on the organizational and technological shift, particularly benefits arrangements.
Interprogram set-off	<ul style="list-style-type: none"> • Establishment of a working group to identify application criteria.

Source: Information obtained from Human Resources Development Canada, March 1997

17.73 Implementing the strategy requires co-ordination and co-operation between program staff and Financial and Administrative Services staff. Despite progress made for certain elements of the strategy, we noted delays in implementing a number of initiatives, and several pilot projects have not yet been finalized. For example, the Department only very recently began developing a single policy on accounts receivable. Furthermore, not all accounts receivable have been transferred yet to the new departmental system.

17.74 We believe an action plan setting out roles and responsibilities, priorities, resource requirements and timetables for bringing the strategy to completion would be beneficial.

17.75 **The Department should complete the implementation of the strategy to integrate and harmonize the management of accounts receivable in order to improve performance results.**

Department's response: We concur with this recommendation and will continue to work toward full implementation of the strategy as quickly as possible so that performance results for all HRDC receivables will be optimized and reflect the benefits of an integrated and harmonized approach to debt management and recovery.

Performance could be better measured and targeted

17.76 Choosing key performance indicators allows management and employees to concentrate on the strategic results promoted by the Department. Although the *Results-Based Accountability Framework* does not specify key or secondary performance indicators for management of accounts receivable, we noted that managers are using some in the majority of accounts receivable (see Exhibit 17.8). The Department recently formed a committee to select appropriate performance indicators for all accounts receivable.

Exhibit 17.8

Performance Indicators and Expectations for Accounts Receivable, by Program - 1997

Employment Insurance	Income Security	Student Loans
Performance Indicators		
Active accounts: <ul style="list-style-type: none"> • amounts recovered Inactive accounts: <ul style="list-style-type: none"> • amounts recovered • unit cost per dollar recovered • recovery rate • write-off amount rate • average payment • recovery by full-time equivalent • penetration effectiveness¹ 	Active accounts: <ul style="list-style-type: none"> • none Inactive accounts: <ul style="list-style-type: none"> • none 	Loans collected by private collection agencies: <ul style="list-style-type: none"> • net recovery rate • number of accounts over six months with a repayment • complaints received • accuracy of accounts • compliance with directives Loans collected by the Department: <ul style="list-style-type: none"> • amounts recovered
Performance expectations		

<p>Active accounts:</p> <ul style="list-style-type: none"> • none <p>Inactive accounts:</p> <ul style="list-style-type: none"> • amounts to be recovered 	<p>Active accounts:</p> <ul style="list-style-type: none"> • none <p>Inactive accounts:</p> <ul style="list-style-type: none"> • none 	<p>Loans collected by private collection agencies:</p> <ul style="list-style-type: none"> • none <p>Loans collected by the Department:</p> <ul style="list-style-type: none"> • none
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¹ Penetration effectiveness is calculated by dividing the average number of cash payments by the average number of inactive accounts.

Source: Information obtained from Human Resources Development Canada

17.77 It is important that performance information cover key elements so that managers can make the most appropriate decisions, particularly in selecting collection methods. The Department uses various collection methods to recover amounts owing as quickly as possible. A comparison by collection method of the amounts recovered with the collection costs would enable the Department to select the most cost-effective method. However, management systems currently cannot provide information about the cost of each collection method. It is therefore difficult for managers to determine the appropriate mix of collection methods to improve performance.

17.78 Exhibit 17.8 shows that performance targets have not been set for a significant portion of the portfolio of accounts receivable. For example, active accounts receivable in the Employment Insurance Program, which represent a substantial portion of that program's total as of 31 March 1997, have no performance targets. With respect to the portion of the student loans portfolio collected by private collection agencies, the Department's view is that performance is a product of sound competition among the agencies, given that new defaulted student loans are allocated to them based on performance achieved according to a set of criteria.

17.79 We believe that setting performance targets for the overall portfolio of accounts receivable would enable the Department to better focus on results and to assess performance. Without performance targets, it is difficult for senior management to determine whether or not strategic directions have been achieved.

17.80 The Department should ensure that performance indicators and targets cover all key aspects of the management of the portfolio of accounts receivable. It should also evaluate the cost effectiveness of various collection methods.

Department's response: We agree with the recommendation that performance indicators for all of the portfolio of accounts receivable be utilized and that collection methods be evaluated for cost effectiveness.

As the Department's Accounts Receivable Strategy evolves and the initiative to harmonize various HRDC program recovery policies is realized, it will enhance our ability to set realistic target levels for all aspects of the management of the portfolio.

A more thorough analysis of performance is needed

17.81 It is essential to know the causes of changes in performance achieved and in collection costs to identify and implement any needed corrective measures in a timely manner. The Department could perform a more thorough analysis of the reasons for such changes in the performance of its collection activities and in the quality of the portfolio of accounts receivable. We present in the following paragraphs examples of analyses that the Department could undertake.

17.82 The analysis in Exhibit 17.9 shows that the annual combined rate of recovery of accounts receivable for the Student Loans and Employment Insurance programs has consistently declined over the last five years, from 24 to 17

cents per dollar available for collection, a decrease of close to 30 percent. This decrease is due, in part, to the decline over the same period in the rate of recovery of accounts receivable for the Employment Insurance Program, from 46 to 37 cents per dollar available for collection.

Exhibit 17.9

(This exhibit is not available, see the Report)

17.83 Our analyses show that the quality of the portfolio of accounts receivable has deteriorated over the last five years, in part because of the increase in the age of accounts receivable. In other words, the older the accounts, the more difficult it is to recover the amounts due. As Exhibit 17.10 shows, accounts receivable in the Employment Insurance Program are becoming older; and the amounts in student loans older than four years expressed as a percentage of the outstanding total increased from 39 percent to 50 percent during the last five years (see Exhibit 17.11).

Exhibit 17.10

(This exhibit is not available, see the Report)

Exhibit 17.11

(This exhibit is not available, see the Report)

17.84 With respect to the Employment Insurance Program, the lower rate of recovery and older age of the accounts receivable are due to a decrease over the last five years in amounts recovered before benefit payments are issued to beneficiaries who owe outstanding amounts. Active accounts receivable are managed by program staff who are not specialized collection agents. Since this program has only one performance indicator and no performance target for managing active accounts receivable (see Exhibit 17.8), it is difficult to determine whether they are managed properly and whether performance results are appropriate.

17.85 We believe that the use of performance indicators and targets for the overall portfolio of accounts receivable would enable the Department to better assess whether the overall performance of the portfolio has improved or deteriorated. The Department has informed us that the Accounts Receivable System now being developed will allow it to compile more performance information and will therefore facilitate analysis of changes in the cost effectiveness of collection activities.

17.86 **The Department should analyze thoroughly the causes of changes in the cost effectiveness of collection activities and in the quality of the portfolio of accounts receivable, in order to identify and implement in a timely manner any needed corrective action.**

Department's response: We concur with this recommendation, and the Accounts Receivable Strategy initiatives, once fully implemented, will provide a means by which the effectiveness of recovery operations generally, and recovery tools and techniques specifically, may be more accurately measured and evaluated, both in terms of efficiency and cost effectiveness.

Certain collection practices can be improved

17.87 This section deals exclusively with accounts receivable collection practices in the Employment Insurance Program and the Income Security Programs. We did not examine the collection practices used by private collection agencies. The Department's collection policies state that an attempt should first be made to obtain the full amount of the debt and that the debtor should expect to have to liquidate certain assets in order to repay the government.

17.88 We noted some areas where collection practices need to be strengthened to improve performance and make management more results-based:

- Collection priorities are not based on debtor risks and profiles. It is essential that collection efforts be properly prioritized in order to recover the amounts owing as quickly as possible.
- Amounts to be recovered from benefit payments destined to debtors are predetermined by the Department. It does not seek to immediately recover the full amount or a large portion of the debt, even if the financial situation of the debtor so permits.
- The debtor's assets are not considered in assessing the capacity to pay as required. The Department's system is not designed to record information on assets.
- Errors and major delays were observed in the recording and recovery of overpayments, as well as errors in accounts receivable balances recorded in the Departmental Accounts Receivable System for the Income Security Programs.

17.89 The Department should strengthen its collection practices to improve performance and make management more results-based.

Department's response: We concur with this recommendation. The HRDC Accounts Receivable Strategy was developed with a view to ensuring that all HRDC debtors are treated in a fair, consistent and equitable manner, while at the same time maximizing recoveries through utilization of the most cost-efficient recovery tools and techniques, targeted to specific categories of accounts. With the full implementation, over the next three years, of all elements of the Accounts Receivable Strategy, the Department will have much improved collection tools and an enhanced capacity to measure the effectiveness of specific recovery methods and practices.

Case 2 — Protection of Program Integrity

17.90 One of the Department's main objectives is to protect public funds against fraud and abuse in order to ensure that payments are made to all those and only those who are entitled to them. The Department has activities to prevent, detect and deter fraud and abuse in the Employment Insurance Program, the Income Security Programs and The Atlantic Groundfish Strategy. We examined whether the management of those activities is results-based. The provinces are responsible for protecting public funds against fraud and abuse in the Canada Student Loans Program.

Management of the integrity of the Employment Insurance Program is results-based

17.91 The *Results-Based Accountability Framework* sets out both the key and secondary indicators of performance for the protection of public funds in the Employment Insurance Program only. Exhibit 17.12 presents a summary of the performance indicators and expectations for the three programs. Since resource levels have been based on expected results, the Program Integrity Directorate in Income Security Programs has measured the results of certain activities for the protection of public funds in terms of total savings. However, the results of other activities are not measured.

Exhibit 17.12

Performance Indicators and Expectations for Protection of the Integrity of Public Funds - 1997

Employment Insurance	Income Security	Atlantic Groundfish Strategy
Performance Indicators		
Primary indicator: <ul style="list-style-type: none"> • total savings 	Primary indicator: <ul style="list-style-type: none"> • none 	Primary indicator: <ul style="list-style-type: none"> • Although no performance

Secondary indicators: <ul style="list-style-type: none"> • return in dollars and on investment • intervention rate • percentage of disqualifications and disentitlements out of the number of claimant investigations • percentage of penalties imposed out of the number of investigations completed • investigations by full-time equivalent (productive time) 	Secondary indicators: <ul style="list-style-type: none"> • none 	indicators are set out in the Results-Based Accountability Framework, the Department uses total savings as the performance measure Secondary indicators: <ul style="list-style-type: none"> • none
Performance Expectations		
• total savings	• none	• none

Source: Information obtained from Human Resources Development Canada, 1997

17.92 The Investigation and Control Directorate of the Employment Insurance Program has, since 1992, managed activities for the protection of public funds in accordance with expected results. It operates at the national, regional and local levels. The differentiation of roles and responsibilities among these three levels is well defined. For example, directors of Human Resource Centres of Canada (HRCCs) are responsible for results; that is, they must make every effort to ensure that the savings expectation expressed in terms of total savings is met.

17.93 Information on results, measured in terms of total savings, is used to negotiate the level of resources required and to set the national savings expectation. Total savings comprise direct and indirect savings. Direct savings measure the value of overpayments detected and penalties imposed. Indirect savings represent the estimated value of improper payments not made as a result of investigations.

17.94 Exhibit 17.13 shows that total savings have grown since 1992, reaching a peak in 1995-96 and then declining in 1996-97. Although the Directorate failed to reach its savings expectation in the last two years, performance measured in terms of total savings is up over the last five years. The increase in total savings is due mainly to indirect savings, which nearly quadrupled from \$68 million to \$249 million during that period.

Exhibit 17.13

(This exhibit is not available, see the Report)

17.95 The adoption of total savings as a key indicator of performance has had a marked impact on the nature and scope of investigation and control activities, by encouraging managers to emphasize not only detection (measured by direct savings) but also prevention and deterrence (measured by indirect savings). Indirect savings as a proportion of total savings more than doubled over the last five years, climbing from 17 percent to 44 percent.

17.96 Efforts in prevention and deterrence have helped to improve the return on investment over the last five years (see Exhibit 17.14). The Directorate told us that a recent decrease in total savings and return on investment was due in part to the introduction of the new *Employment Insurance Act* in June 1996 and to the overall reduction in the size of the program in terms of benefits paid. The new *Employment Insurance Act* has required a major effort to train investigators, which has contributed to reducing the number of investigations each one conducts.

Exhibit 17.14

(This exhibit is not available, see the Report)

17.97 The use of performance indicators and expectations enables results-based management of the protection of the integrity of the Employment Insurance Program. However, this is not the case for Income Security Programs and The Atlantic Groundfish Strategy, which lack performance indicators and expectations.

17.98 The Department should ensure that the results of all activities for the protection of public funds against fraud and abuse in Income Security Programs and The Atlantic Groundfish Strategy are properly measured and that expectations are set in order to manage for results.

Department's response: We concur with this recommendation.

Performance could be analyzed more thoroughly

17.99 The Investigation and Control Directorate of the Employment Insurance Program has made major progress toward results-based management in the last five years. It has refined its methods of measuring and communicating results and has broadened its investigative methods to improve performance. However, we did note room for some improvements that would make management more results-based.

17.100 The national savings expectation is distributed among the regions. However, some regions do not allocate savings expectations among Human Resource Centres of Canada (HRCCs), or do so informally. Uniform methods of allocating savings expectations would make it easier for Centre directors to accept the expectation and would facilitate comparison of performance among Centres in the various regions.

17.101 Comparing results obtained with costs incurred makes it possible to assess the cost effectiveness of activities to protect public funds. The Department calculates return on investment at the national level and for each region and HRCC, in order to compare results with costs. Since no expectation is set for this performance indicator, however, it is difficult to determine whether or not the activities for protecting public funds are cost-effective.

17.102 The Investigation and Control Directorate uses a variety of investigative methods to reach the national savings expectation. Although it measures the total savings generated by each investigative method, it does not assess the cost effectiveness of each method because its information on costs is not detailed enough. It is hence difficult for managers to determine an appropriate mix of investigative methods to improve the cost effectiveness of activities.

17.103 The Directorate regularly prepares and communicates information on performance indicators. Performance varies significantly among regions and among HRCCs. A more thorough analysis of the causes of performance differences would be beneficial; by examining actual performance compared with expected results, the Directorate could identify any needed corrective actions. For example, the Business Plans of the Centres could clearly indicate the causes of discrepancies between actual and expected results and the appropriate corrective actions to be taken. We note that the Directorate recently set up, at the national level, a special unit whose mandate includes analyzing more thoroughly the causes of performance variances among regions.

17.104 The Investigation and Control Directorate of the Employment Insurance Program should conduct a thorough analysis of the causes of discrepancies between actual and expected results and of changes in cost effectiveness in order to report properly on results achieved and to identify the need for corrective action.

Department's response: We agree with this recommendation, and this process is already under way. We have a three-pronged approach: 1) an evaluation study by HRDC's Strategic Policy Branch; 2) a survey of front-line staff; 3) more in-depth analysis of administrative and performance data. All of this will be discussed by senior managers, at the director-general level, at Management Board and with the Commissioners.

Conclusion

17.105 The Department has recently undertaken a transition toward results-based management. It has launched a number of initiatives such as the selection of performance indicators, the setting of expectations, and consultations with employees. In addition, the roles and responsibilities of the various federal partners in the administration of two of the largest programs (the Canada Pension Plan and the Employment Insurance Account) are, overall, well defined. We concluded that the Department has made progress toward the completion of the transition.

17.106 Nevertheless, the Department still needs to take certain key steps that are critical to the success of an initiative of this magnitude. It needs to ensure that it has chosen its key performance indicators carefully and that they are relevant over time. It also needs to set expectations for all its programs and to ensure the credibility of the data that employees consider most important.

17.107 Our examination of the management of accounts receivable and the protection of program integrity confirms our conclusion that major progress has been made in results-based management but that certain steps are still needed in the area of performance measurement and analysis.

17.108 In addition, at the present time, very little information on results is communicated to Parliament. The information that is provided on the Employment Insurance Account can be greatly improved. With the implementation of the *Results-Based Accountability Framework*, the Department has positioned itself to start providing Parliament with better information on results.

17.109 Measurement of performance results, and follow-up, will require a firm commitment by senior management and the co-operation of all members of the organization, at the local, regional and national levels. The recent experience acquired by the Investigation and Control Directorate in the Employment Insurance Program could provide senior management with guidance and encouragement. Decisions and adjustments will be necessary if results measurement is to strike an appropriate balance among the effectiveness, cost and quality of services.

About the Audit

Objectives

The objective of our audit was to examine one of the major elements of the *Results-Based Accountability Framework* — results-based management. More specifically, we sought to:

- examine progress achieved toward results-based management;
- determine whether the Department is appropriately fulfilling its responsibilities and reporting on performance achieved on the basis of performance expectations for two selected activities — management of accounts receivable and protection of program integrity; and
- examine information to Parliament on the Department's two largest programs (the Canada Pension Plan and the Employment Insurance Account), including information on results.

Scope

Our audit covered the implementation of results-based management for the entire Department. In order to better assess progress in the transition toward results-based management, we examined management of accounts receivable and protection of program integrity. Chapter 11 on a government-wide study entitled *Moving toward Managing for Results* identified some lessons learned and best practices in results-based management by the Investigation and Control Directorate of the Employment Insurance program.

We examined the information on results communicated to Parliament. Our audit efforts here were focussed on the Department's two largest programs, the Canada Pension Plan and the Employment Insurance Account.

We interviewed officials at headquarters and some partners of the Department such as the Chief Actuary of the Office of the Superintendent of Financial Institutions. We visited three collection centres, two Human Resource Centres of Canada and two regional offices, located in Ontario and Quebec. We analyzed planning documents, minutes, performance reports and other related documents. As appropriate, we used the work and the related reports of the Internal Audit Bureau.

Criteria

- A management framework for implementing results-based management should be established to ensure, among other things, that initiatives and related activities are closely linked to the Department's mission and operating principles.
- Roles and responsibilities should be clearly defined and accepted in order to promote accountability and achievement of performance and results.

- Reasonable expectations of performance and results should be clearly set out and accepted in order to fulfil responsibilities and achieve objectives.
- Sound management practices and appropriate management systems should be used in order to suitably fulfil responsibilities.
- Information on performance and results should be credible, analyzed and communicated in a timely manner to senior management and Parliament for decision making and accountability.

Quantitative information

The quantitative information in this report has been drawn from various sources indicated in the text. Unless otherwise indicated, reasonableness of this information has been examined but not audited.

Audit Team

Martin Dompierre
Louise Dubé
Yves Genest
Michèle Lavallée
Jean-Pierre Plouffe
Yvon Roy

For information, please contact Louis Lalonde, the responsible auditor.

Chapter 18

Revenue Canada and Department of Finance

Fostering Improvement in
Tax and Trade Administration: Follow-up of
Previous Audits

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Revenue Canada and Department of Finance

Fostering Improvement in Tax and Trade Administration: Follow-up of Previous Audits

Assistant Auditor General: Shahid Minto
Responsible Auditor: Jim Ralston

Main Points

18.1 Over the last few years, Revenue Canada and the Department of Finance have made many changes to systems, procedures and practices that have strengthened tax and trade administration. Some of these changes are a result of the departments' own commitments to improving their operations; some changes were in response to reports of parliamentary committees; and other changes were made to respond to our observations and recommendations in reports on our value-for-money audits.

18.2 Our follow-up on previous recommendations found that progress is being made on a number of fronts. We encourage the two departments to continue their efforts to address the areas where concerns remain.

18.3 Revenue Canada is now making available more income tax advance rulings and GST rulings and interpretations and has taken steps to improve its documentation of key decisions leading to advance rulings.

18.4 The Department continues to have difficulty completing reviews of income tax returns selected for scrutiny during the annual processing program. It has expanded the number of processing review fields it is tracking, and it is maintaining year-to-year consistency in the fields chosen. Data quality improvements are expected to improve Revenue Canada's ability to analyze and evaluate the performance of the processing program.

18.5 The integration of collections for income tax, GST and customs and excise, the establishment of a risk analysis system, and changes in collection procedures are expected to enhance the collections function. A new procedure for early contact on large delinquent accounts is proving to be very productive, bringing in \$181 million in 1996-97. Revenue Canada has published guidance on applying the Fairness Package and has established a system to track its use.

18.6 The Department is shifting from an audit selection strategy focussed on identifying individual taxpayers to one focussed on industry sectors. It is also trying to take advantage of administrative consolidation to increase audit visibility and coverage. However, the Department still does not have a verification program aimed at RRSP contributions. Through improved reporting of social insurance numbers and sharing of data with other federal departments and provincial governments, Revenue Canada is improving its ability to pursue income tax non-filers and GST non-registrants.

18.7 It has developed a process to manage the risk associated with complex tax legislation, which can be a source of revenue leakage if provisions can be used for tax avoidance. It has also improved the collection and reporting of performance data across a number of its programs.

18.8 In trade administration, Revenue Canada's periodic verification initiative and country-of-origin audit program are expanding. The Department's small importer strategy has been formulated and implementation started.

18.9 With respect to tax assistance for retirement savings and income tax incentives for research and development, the Department of Finance has taken steps to provide improved estimates of program costs and to provide evaluations of program effectiveness. It has also taken steps to correct technical deficiencies in the law related to foreign affiliates and taxpayer migration.

Introduction

18.10 Revenue Canada and the Department of Finance have made many changes to their systems, procedures and practices that have strengthened tax and trade administration. This is evident in the Government of Canada Budget Plan - 27 February 1995, as illustrated in Exhibit 18.1. Some of these changes are a result of the departments' own commitments to improving their operations; some were made in response to reports of the Public Accounts Committee; and others were made to respond to our observations and recommendations in reports on our value-for-money audits.

Exhibit 18.1

Government of Canada Budget Plan - 27 February 1995

Strengthening the Performance of the Tax System

The Auditor General has chosen this area for special attention in his report. He states that action is required to safeguard the tax base and to prevent the erosion of federal revenues. The vast majority of taxpayers comply with the tax laws; however, some do not. Non-compliance with tax law results in lower tax revenues and undermines the government's ability to fund programs and service the debt. The integrity and fairness of the tax system depends on all Canadians paying the tax they owe.

Specifically, the Auditor General refers to the need for effective tax collection practices and for appropriate enforcement strategies that will improve detection and action against those not complying with the tax laws. This budget proposes the following actions aimed at ensuring that taxes are paid on time and that Revenue Canada's ability to enforce compliance is improved:

- increasing the interest rate on unpaid income taxes;
 - enhanced reporting requirements in respect of payments made within the construction industry;
 - new reporting requirements for foreign investments including foreign trusts;
 - improving Revenue Canada's ability to require production of information on third parties in order to verify compliance;
 - improving Revenue Canada's approach to the audit of large business; and
 - tightening the rules with respect to the remittance of source deductions and GST.
- In addition, Revenue Canada has taken a number of steps to address the concerns expressed by the Auditor General:
- consolidating taxation and excise/GST collections programs and implementing joint income tax/GST audits;
 - achieving efficiencies through exchanges and sharing of client information, integrated collections actions and computer cross-references and links;
 - establishing a Compliance Research Division in Revenue Canada to better identify non-compliance and ways to improve compliance; and
 - implementing a communications strategy under which prosecutions and convictions are publicized in order to deter non-compliance.

The Auditor General also noted that customs officers were overburdened and that there was a consequent loss of customs revenue. In response, Revenue Canada is undertaking a fundamental re-engineering of Customs' commercial operations to redesign the relationship with clients. Further, it is moving to more self-assessment which puts greater responsibility on the importer.

Finally, the Auditor General commented on the need for better monitoring and reporting on the performance and results of the tax expenditures on research and development and on retirement savings. With regard to research and development, a Revenue Canada-Department of Finance working group has been established to improve the information flow between the departments. In addition, as noted above, a joint Finance-Revenue Canada evaluation of the scientific research and experimental development tax incentives is

underway and the results will be published once this work is complete. Similarly, an evaluation of the 1991 reforms to the tax assistance for retirement savings is also being undertaken and the results of this study will also be published.

18.11 A strong tax administration is needed to provide government with a reliable stream of revenue to fund its programs. A strong tax administration protects the integrity of the tax base. For an income tax, the tax base comprises the total taxable income of taxpayers; for a consumption tax like the Goods and Services Tax, it is the total value of taxable transactions that occur in the economy. The tax base is one of the most valuable assets of a civilized society, and parliamentarians, government and the public have a vested interest in preserving it.

18.12 Protecting the integrity of the tax base means ensuring to the greatest possible extent that people report their income and transactions truthfully and pay the taxes that they owe. Canada has chosen a self-assessment system for collecting taxes, which puts the onus on each person or business to calculate the amount of tax due. People are most likely to comply with these obligations if they are satisfied that the tax system is fair. They have a right to expect that those who do not pay their fair share will be detected and dealt with accordingly.

18.13 To the extent that trade administration results in the generation of revenue from customs duties, the preceding remarks apply equally. However, in addition, trade administration is increasingly aimed at enabling Canadians to participate more effectively in the international marketplace and to reap gains from trade.

18.14 This chapter follows up on 15 value-for-money audits conducted between 1992 and 1996, and discusses the extent to which Revenue Canada's and the Department of Finance's actions on our recommendations and on those of the Public Accounts Committee (PAC) have improved tax and trade administration. We followed up on all of the PAC's and our recommendations from those audits and are reporting on the more significant ones and on those where we feel progress has been unsatisfactory. Further details on the follow-up scope and objective are found at the end of the chapter in the section **About the Follow-Up**.

Conclusions

18.15 It is our practice to select audit topics to cover as much of the "audit universe" as practical in a cycle that extends over eight to ten years. The five years of audits covered here represent only a slice of the audit universe. Some key departmental activities were not touched upon in this set of audits. We have not exhausted the analysis of any one activity and we have not covered each activity to the same extent.

18.16 However, we do believe that Revenue Canada has made satisfactory progress in addressing most of the recommendations contained in the audits followed up in this chapter and the related recommendations of the Public Accounts Committee, and in advancing certain of its initiatives that were identified in the original audit reports.

18.17 We continue to have concerns about some matters previously reported, and we again urge Revenue Canada to take appropriate remedial action.

18.18 We are generally satisfied with the Department of Finance's response to our recommendations and to those of the House of Commons committees that considered our reports dealing with taxation. While they are not yet available, we anticipate better estimates of tax expenditures and better evaluations of the extent to which the programs of tax assistance for retirement savings and incentives for research and development are achieving their objectives. In addition, the government has taken action to deal with technical deficiencies in law related to foreign affiliates and taxpayer migration.

REVENUE CANADA

Tax Administration Framework

18.19 The findings of our follow-up are organized in this chapter using a simplified tax administration framework (see Exhibit 18.2) patterned on Revenue Canada's official activity structure. This section explains the elements of our simplified tax administration framework.

Exhibit 18.2

(This exhibit is not available, see the Report)

18.20 Facilitation. Overlaying all other tax administration functions are Revenue Canada's efforts to help taxpayers, registrants, etc. comply with their obligations under the tax system. Facilitation takes many forms, such as communicating to clients their rights and obligations, providing the necessary forms and information for filing returns, and responding to client enquiries. The Department also issues various kinds of rulings that explain how certain transactions ought to be treated for tax purposes or that confirm or deny a taxpayer's interpretation of the way a proposed transaction ought to be treated. The goal is to create a better-informed body of taxpayers, registrants and others.

18.21 Tax Roll or Registry. Revenue Canada needs to maintain a complete and accurate "tax roll" of taxpayers and employers (income tax), registrants (Goods and Services Tax), and licensees (excise tax and customs duty), by or through whom taxes are paid. In addition, it keeps certain special purpose registries, such as a registry of pension plans in respect of which taxpayers may claim deductions for their contributions. A tax roll or registry is simply a record of pertinent information that enables the Department to communicate with taxpayers, employers, registrants, licensees and plan administrators to facilitate or enforce compliance with the tax system. Identifying persons who should be added to or deleted from a particular tax roll or registry is a basic and vital function of tax administration.

18.22 Processing. For taxpayers, employers, registrants and licensees, compliance with the tax system means making payments and sending in various information returns to Revenue Canada, traditionally on paper, but increasingly in electronic format. This amounts to millions of transactions each year, which the Department has to process promptly and accurately. A very important aspect of processing transactions is applying automated and manual controls and procedures that identify and respond to indicators of actual or potential non-compliance.

18.23 Collections. Taxpayers, employers, registrants and licensees are supposed to remit their taxes to Revenue Canada voluntarily. The amount of the tax liability may have been determined by self-assessment or an assessment by Revenue Canada. When debtors fail to or are unable to pay their tax liabilities, for any reasons, Revenue Canada has to take action to collect the amounts due. The action it takes depends on the circumstances.

18.24 Audit and Enforcement. Because Canada uses a self-assessment system of taxation, Revenue Canada needs to carry out a limited program of checking (auditing) to ensure that taxpayers, registrants, etc. are complying properly with their obligations to report information and calculate their tax liability. When the Department finds errors or non-compliance, it issues new assessments or takes other corrective action. In cases where Revenue Canada suspects fraudulent activity, it may seek criminal prosecution through its enforcement arm, Special Investigations.

18.25 Dispute Resolution. Revenue Canada maintains a separate organizational unit that reviews assessments raised by the Department that taxpayers believe are incorrect. If a matter referred to this unit is not resolved to the satisfaction of the person who raised the objection, it may be appealed to the tax court, which is fully independent of Revenue Canada. (Although it is a vital element of tax administration, none of the tax-related audits followed up in

this chapter dealt with dispute resolution. In 1995 we followed up our previous work in this area, originally reported in a 1992 chapter on resolving disputes on income tax assessments).

18.26 Policy and Legislation. In the course of administering the tax system, Revenue Canada becomes aware of anomalies or ambiguities in legislation. Audit and appeals activity are important sources of this kind of information. The Department may clarify or correct such problems by issuing its own policy statements or may ask the Department of Finance to amend the legislation, depending on the circumstances.

18.27 Monitoring and Reporting. Each of the functions we have discussed has to be managed appropriately and information on its efficiency and effectiveness reported to Parliament. Both of these tasks depend on having and using suitable information systems.

Observations

Compliance Strategy

Risk assessment guides compliance strategy

18.28 How Revenue Canada uses the elements of the tax administration framework is determined by its compliance strategy. Revenue Canada has always used all of the elements but increasingly has asked itself whether it is using them in proper proportion and in the most effective way. We have seen a change in Revenue Canada's strategy in recent years. As the Department describes it, "Today's approach relies on sophisticated risk assessment and risk management techniques made possible through advanced computer technologies." Underlying this approach is a much greater focus on using more and better information to guide the Department's actions.

Facilitation

Publishing more rulings enhances facilitation

18.29 Our 1993 Report (Chapter 20) dealt in part with advance income tax rulings. These are written statements given to a taxpayer by Revenue Canada specifying how the Department will interpret and apply particular legislative provisions to a specific transaction or transactions that the taxpayer proposes to carry out. We observed in 1993 that few of the departmental positions responding to requests for advance income tax rulings were made public, even though many would be of interest to other taxpayers. Accordingly, we recommended that Revenue Canada release to the public, in severed form, all advance rulings issued. By "severed form" we mean in a manner that keeps confidential the identity of the taxpayer who sought the ruling.

18.30 Our follow-up noted that since 1 January 1996 the majority of income tax rulings have been severed and are available to the public electronically in Revenue Canada's offices across the country. To protect confidentiality, the taxpayer requesting a ruling is asked to approve the severed version before it is published. The Information Circular explaining the rulings process has been updated and the revised circular states that agreement to the publication of a severed ruling is a condition for obtaining a ruling.

18.31 In the interim, the Department has realized that when there are more than two parties to a ruling it is difficult, if not impossible, to follow the facts and proposed transactions after the taxpayers' names have been severed. It is currently considering a number of enhancements to make the severed rulings as useful as possible to taxpayers.

18.32 The same 1993 chapter contained observations on three classes of GST rulings: advance rulings, application rulings and interpretations. It noted that communicating more information to the public on rulings and interpretations would increase equity among GST registrants. Revenue Canada is now providing subscribers (mainly tax publishing houses) with an electronic version of all GST rulings and interpretations, in severed form, prepared in departmental headquarters. However, GST rulings and interpretations prepared in Tax Service Offices are not distributed.

Department to improve documentation of key decisions leading to advance rulings

18.33 In response to our May 1996 audit observation concerning the movement out of Canada of at least \$2 billion of assets held in family trusts, the Minister of National Revenue announced improvements to the Department's documentation practices in respect of advance rulings. Our report had noted a lack of documentation and analysis of key decisions leading to the issuance of certain advance rulings.

Community visits combine facilitation and enforcement

18.34 One of the Department's action plans lists an example of a new approach that combines facilitation and enforcement: visiting local businesses to obtain information and provide advice to ensure proper filing and registration. Revenue Canada reports that it has visited over 21,000 businesses in 126 communities. One third of the businesses visited required further action to improve their compliance.

Tax Roll

Reporting of social insurance numbers has increased

18.35 When people file income tax returns for the first time, their names are inscribed on the tax roll. In the case of the GST, businesses identify themselves to Revenue Canada by applying for a registration number (the Business Number). Similarly, for an excise tax like the air transportation tax, companies apply to be licensed. In each case, once Revenue Canada is aware of a person's or a business's existence, it can monitor compliance with the tax laws.

18.36 Because identification is so important, the Department has programs aimed at identifying non-filers and non-registrants. Our 1994 chapter on detection of non-filers looked at this problem with respect to income tax.

18.37 The key to finding those whose names should be on the tax roll but are not is to obtain from an independent source of information a clue to their existence and an indication that they ought to be paying tax. One such source is the record of investment earnings ("T5 slips") that financial institutions have to prepare. To be most useful to Revenue Canada, T5 slips have to contain the social insurance number (SIN) of the person who received the investment earnings. This makes possible computerized matching of the T5 slips to income tax returns, on which the SIN appears. Although people are required by law to give their SIN to financial institutions, many do not, despite reasonable efforts by financial institutions to obtain the numbers.

18.38 Our chapter noted that, for the 1992 taxation year, only 73 percent of T5s contained SINS. For the 1995 taxation year, Revenue Canada reports that 89 percent of T5 slips contained SINS. A rate of 100 percent is not expected because many recipients are corporations or businesses that do not have SINS or are individuals under the age of 18 years, who are not required to supply a SIN to financial institutions (see Exhibit 18.6).

18.39 While the Department is satisfied with this compliance rate for 1995, it hopes to improve it further by working with financial institutions. Also, Revenue Canada would like the legislation amended to require

corporations and businesses to supply their Business Numbers on T5 slips, making possible computerized matching to the Department's business-related databases.

18.40 Just as audit and enforcement benefit from Revenue Canada's supply of information and its compliance research, so do the non-filer and non-registrant programs. The Department now uses data from other federal and provincial government departments to identify specific individuals or corporations who may be non-filers or non-registrants. Revenue Canada will also examine the most recent census information by municipality to determine the degree of non-compliance in different areas of the country — important information for guiding strategy.

18.41 The Department reports that, once identified, 80 percent of non-filers begin to file tax returns voluntarily. It follows up on the remainder and, within three years, almost all file their tax returns voluntarily.

Processing

Continued difficulty in completing reviews of selected returns

18.42 During the 1990s, Revenue Canada significantly restructured its method of processing personal income tax returns. It replaced manual practices with new technologies, and is using different approaches to verifying information reported on returns. In 1995, we reported our concerns about the Department's capability to contain the risks of lost tax revenue in the new returns-processing environment.

18.43 Revenue Canada's "confidence validity" (CV) program looks at each return and is designed to target the most risky or suspicious returns for manual review prior to initial assessment. A computer selects returns according to criteria known as confidence validities. Because the CV program selects only the most risky and suspicious returns, it is important that all of those be reviewed before the initial assessment. The 1995 audit noted that this was not happening. Moreover, there was no certainty that all returns selected but not reviewed before initial assessment would be reviewed after the initial assessment notice was issued.

18.44 Changes made for the 1995 processing year were meant to ensure that any "high-risk" returns not reviewed before initial assessment would be examined afterward. Revenue Canada monitors returns that are bypassed (selected but not reviewed) at the confidence validity stage. Over the course of the CV program in 1996, over 100,400 returns were selected for review. About 16,700 (17 percent) of those were bypassed for various reasons. The post-assessment review program dealt with 14,800 of the bypassed returns, leaving 1,900 that were not reviewed at the second stage. Those cases were concentrated in a few taxation centres, and most were not reviewed because staff resources were insufficient to handle the volume of returns awaiting review.

18.45 At a Revenue Canada CV conference in October 1996, it was agreed that workload forecasting would be improved, that tax centres would take steps to improve staffing and training for this program, and that additional resources would be allocated for the 1997 program. Also, in 1997 new weekly reports were provided to help the tax centres manage CV inventories and reduce backlogs. As of 20 May 1997, only 126 of the 34,238 returns processed for the CV program had been bypassed.

18.46 In the 1995 audit, we also found that the Department had not examined all returns for tax years 1992 and 1993 (only 92 percent in 1992 and 92.9 percent in 1993) that had been chosen for random sampling under the processing review program (a post-assessment verification activity), even though its policy was to review all such returns. This policy is intended to ensure that the results obtained in the processing review program are representative of the underlying populations, given that Revenue Canada relies on this program to estimate the level of voluntary compliance by taxpayers.

18.47 During the 1995 program, 90.5 percent of the returns chosen for the random sample were reviewed. For the 1996 program, 91.9 percent of the returns chosen for the random sample had either been or were being reviewed as at 6 May 1997. Revenue Canada states that some returns were not available for review because they were charged out to other areas such as audit. Certain other cases were not reviewed because of mid-year adjustments to administrative policies regarding claims to be checked in the Processing Review Program.

18.48 It is evident that, in the 1995 and 1996 random sample program, about the same percentage of selected samples were being reviewed as in 1992 and 1993. While the sample completion rate seems quite high, the uncompleted portion of the sample may have characteristics that are significantly different from the completed portion. Were this to be the case, the conclusions that Revenue Canada drew from analysis of only the completed portion could be seriously in error. To safely ignore the uncompleted portion of the sample, Revenue Canada would have to be sure that its characteristics were essentially no different from those of the completed portion. However, the Department does not have this assurance. Accordingly, we urge the Department to take appropriate action to ensure that all returns chosen for the random sample are reviewed.

Department's comments: The Department remains committed to further improving the review rate for random sampled cases, but 100 percent completion is an unrealistic objective. In large sampling projects, some cases will always be unavailable for review, and the sample design takes this into account. The Department is confident that the completed cases constitute a representative sample. Data from prior years and from the compliance workload are used in sample design and quality checking.

More and better data available but still little analysis of performance

18.49 Our 1995 audit noted the small number of line items (six) selected for review on each return for the 1994 taxation year. Furthermore, it noted that the line items selected varied from one year to the next in both electronically filed (EFILE) and paper returns, and also varied between paper and EFILE returns. We were concerned that this lack of consistency would impair the Department's ability to monitor trends in voluntary compliance because it would not have sufficient comparable information.

18.50 For the 1995 taxation year, 27 processing review fields were covered in the random sample for paper returns and 24 fields for EFILE returns. For the 1996 taxation year, 24 fields are being covered for paper returns and 21 fields for EFILE returns. This is a substantial increase over the number covered in our 1995 audit of the 1994 taxation year. It will improve the Department's ability to monitor trends in voluntary compliance. The decrease by three in the number of fields being covered for the 1996 taxation year is due to a legal challenge to the taxability of certain income, and to changes in the way certain claims are processed.

18.51 Our 1995 chapter recommended that Revenue Canada use statistics from its compliance monitoring and enforcement programs to analyze trends and patterns of non-compliance. The information could be used in developing criteria for selecting returns to review, and then in evaluating how well the criteria perform. It could also be used to evaluate the overall performance of the new processing regime.

18.52 In 1995, we noted problems in the quality of data from the 1993 processing review program; Revenue Canada subsequently discovered some more problems with the data. The Department postponed much of its analysis while it worked to correct the remaining errors in its data. Aside from data quality, co-ordination problems within the Department have resulted in delays in generating some of the data needed for analysis.

18.53 Because of these difficulties, the Department has so far performed only a limited analysis of non-compliance trends and patterns using 1994 and 1995 processing review program data. We extended the analysis to 1996 using preliminary data, and found that there does not appear to be any clear trend in non-compliance over the period in the group of data fields available for all three years. However, even the most recent random sample data reveal rather high adjustment rates (exceeding 10 percent) in many fields. In addition, using data from the matching program, the Department found that the average value of adjustments it made to EFILE returns was higher than the

average value of adjustments to paper returns for 1994. In particular, adjustments for child care, spousal amounts and other family-related claims were higher for EFILE returns. The reasons for this are not yet fully understood.

Department's comments: The Department acknowledges that the process of extracting, assembling and cleansing the data it needs for analysis has been more time-consuming than expected. However, these preparatory steps are essential to effective analysis and decision support in any business context.

At this time, no definite conclusion can be reached about hypothetical differences in the compliance rates for EFILE and paper returns. Data being gathered via the random samples for the years 1995 and 1996 will enable valid trend analysis. Since the EFILE and paper returns covered by the Matching program are not based on equivalent geographical areas, the adjustment rates are not comparable. No inference can be drawn about the rates that might apply to other deduction or credit items.

18.54 Our analysis during our 1995 audit revealed that the scoring system used by the Department to evaluate the riskiness of returns was weak and needed improvement. Our updated analysis of the scoring system in place during the 1996 program year also indicated room for improvement. However, we are encouraged by the Department's recent development of new scoring criteria based on statistical analysis of program data. The new criteria have been implemented in 1997. In addition, the Department has been experimenting with other techniques — referred to as “neural networks” — that may serve as a complement to the kind of scoring system now in use.

18.55 Regarding evaluation of the overall performance of the new processing regime, the Department has drafted an evaluation framework that proposes some useful indicators of program effectiveness. However, we believe that the framework can be improved. Clear measures need to be defined to evaluate such questions as whether the proper levels of resources are being devoted to paper and EFILE reviews, whether the mix between CV reviews and processing reviews is appropriate, and what fields should be subject to review. It would also be appropriate to define a timeline that shows when the various aspects of the evaluation would be done.

Department's comments: The Department appreciates the suggestions for improvement included in this paragraph and will incorporate them in its evaluation plans.

Backlog of unprocessed pension plan files is declining

18.56 Our 1994 chapter on tax-assisted retirement savings pointed to severe delays and backlogs in registering and approving amendments to pension plans. We reported that 20,105 files were awaiting processing as at 1 April 1994; this number increased to 24,028, its highest level, in June 1994. Thanks to a number of measures, Revenue Canada had reduced its comparable inventory of unprocessed files to 8,732 by 24 March 1997 (see Exhibit 18.3).

Exhibit 18.3

(This exhibit is not available, see the Report)

18.57 To achieve the reduction, the Department hired more staff and changed the staff mix to match the composition (in terms of complexity) of the files examined, improved work flows, used assessments of risk to guide the review process, and transferred the review of wind-up and conversion reports to a desk audit program that is done at a later time. Revenue Canada also consulted with pension industry representatives to come up with plan prototypes in an attempt to improve the quality of documents submitted to the Department for review.

18.58 At 1 April 1994, 40 percent of the unprocessed pension plan files were more than six months old; by 24 March 1997, this had decreased to 27 percent. The Department's current published standards for registration or termination of a pension plan is 180 days. However, the Department believes this is an inappropriate standard to apply to pension plan amendments, which it says make up the majority of the unprocessed files. Revenue Canada

intends to soon publish a less demanding standard for amendments, in recognition that these are lower-priority items. Good progress has been made in processing pension plan files.

Collections

New system for income tax accounts receivable to be used for other taxes

18.59 Our 1993 audit observation on overdue GST, our 1994 chapter on collecting income tax debts, and our 1995 chapter on the air transportation tax each dealt with collecting tax debts. The 1994 chapter dealt with the topic in most depth and will be the focus of this section. However, given that the collection function has been significantly affected by the administrative consolidation of the former departments of Taxation and Customs and Excise to form the present Revenue Canada, our comments on the current collection regime generally apply to all types of tax debts.

18.60 Growth in accounts receivable. When we published our 1993 audit observation, the GST had been in place for just over two years. Accounts receivable were increasing and had reached \$650 million by March 31 of that year. But given that there were also 576,000 registrants who were delinquent in filing returns, the accounts receivable balance was likely understated. Indeed, GST accounts receivable have continued to rise, totalling \$1.6 billion by the end of the 1995-96 fiscal year. Exhibit 18.4 shows how unpaid GST has increased each year while unpaid income tax debts have tended to level off over the last few years.

Exhibit 18.4

(This exhibit is not available, see the Report)

18.61 In 1994, we reported that unpaid income tax debts had grown from \$4.2 billion in 1988-89 to \$6.6 billion in 1993-94, an increase of 58 percent. Over the same period, net federal income tax revenue had grown from \$70.6 billion to \$80.4 billion, an increase of 14 percent. Thus, the growth in unpaid income tax debts outpaced the growth in net federal income tax revenue. Our follow-up noted that by the end of fiscal year 1995-96, unpaid income tax debts had increased by another 3 percent to \$6.8 billion, while net federal income tax revenue had increased by 20.3 percent to \$96.7 billion. This means that growth in unpaid income tax debts was now slower than growth in net federal income tax revenue. Exhibit 18.5 shows that the percentage of unpaid income tax debts to income tax revenue has decreased since 1993-94, while the percentage of unpaid GST to GST revenue has increased each year.

Exhibit 18.5

(This exhibit is not available, see the Report)

18.62 Changes to the collection regime. The 1994 chapter criticized certain aspects of Revenue Canada's collection regime. We stated that the Department could improve its collection performance by changing the way it judged the riskiness of a delinquent account and by tailoring its collection procedures for a particular account according to that risk. We also noted areas where we felt management's monitoring of the performance of the collection function could be improved.

18.63 After visiting private industry and upon completing a benchmarking process, the Department developed and tested a risk analysis system that can classify accounts receivable according to compliance patterns or potential for loss. This system has been implemented for individual income tax accounts, with the intention of also incorporating payroll deductions, corporate income tax, GST, customs and excise accounts in the future. The system will operate by directing accounts to the most efficient recovery process to be used — whether written notices, call centre reminders or more intense collection action by staff in one of the Tax Services Offices (TSOs).

18.64 In addition, 11 of the larger TSOs began the practice of making early contact with taxpayers on accounts over \$100,000. During 1996-97, of 1,350 accounts on which early contact was made, 341 were paid in full and a total of \$181 million was collected (see Exhibit 18.6).

Exhibit 18.6

Examples of Follow-up on Our Recommendations, PAC Reports, Revenue Canada Initiatives and Progress Made

Topic	OAG Recommendation	Public Accounts Committee Report/ Recommendation	Revenue Canada Initiative	Progress
Social Insurance Numbers	<ul style="list-style-type: none"> Continue initiative to obtain social insurance numbers for those information slips pertaining to individuals. Investigate other options, including reconsidering a withholding requirement, in cases where a valid SIN is not provided and recommend legislative changes. 	<ul style="list-style-type: none"> Department should report to the Committee stating whether various objectives have been achieved. For example, the target for 1995-96 fiscal year for getting SINS on T5s issued by financial institutions is 90 percent. 	<ul style="list-style-type: none"> The Underground Economy Initiative focusses on non-compliance by.... possible reporting and information changes, including steps to improve reporting of SINS on the T5 slips. 	<ul style="list-style-type: none"> For the 1996 processing year, the SIN compliance rate on T5 slips was 89%. Department will continue to work with the financial institutions to ensure a greater level of compliance in SIN reporting. Legislation changes requested, which are currently being studied by the Current Amendments division.
Collection Procedures	<ul style="list-style-type: none"> Collect on large debts soon after they become due. 	<ul style="list-style-type: none"> Expected Department to be fast-tracking the collection of large debts. Early systematic contact with the taxpayer allows for assessment of danger of loss and negotiation of payment arrangements. 	<ul style="list-style-type: none"> Monitor large debtors for danger of loss Test effectiveness of contacting taxpayers for voluntary payment prior to the date on which enforced collection action may begin. 	<ul style="list-style-type: none"> Early contact on large accounts (over \$100,000) implemented in 11 Tax Services Offices. During 1996-97 contact made on 1350 accounts, 341 accounts paid in full, a total of \$181 million collected.
Fairness Package	<ul style="list-style-type: none"> Track requests and decisions granted under the Fairness Package. Monitor circumstances in which adjustments made. Develop policies and practices for use of the Fairness Package. Monitor the effects on taxpayer compliance. 	<ul style="list-style-type: none"> Concerned that the Department could not determine the total value of reassessments made under the Fairness Package since 1991. Concerned there were insufficient guidelines ensuring uniform application of the Package. 	<ul style="list-style-type: none"> Annual report giving the cumulative total of all decisions made under the Fairness Package. Procedures designed to increase uniformity to be in effect no later than August 1995. 	<ul style="list-style-type: none"> April 1, 1996, tracking fairness decisions and amounts forgiven, including breakdown by reason of cancellation. Distributed guidelines for use of fairness package and tracking system. National Fairness Committee established to co-ordinate fairness issues.

18.65 An on-line collections manual is now in place, combining policies and procedures for GST and income tax. It includes standards for assessing, documenting and verifying information pertaining to debtors' ability to pay, and standards of performance by collectors for such things as nature and frequency of debtor contacts, time frames for resolving accounts and use of legal action. All these standards are monitored by departmental headquarters.

18.66 Except for the results from early contact on large accounts, it is hard to point to evidence that the changes in the collections program are having an impact. Nevertheless, we feel the changes make sense and should prove to be beneficial.

Better control over use of the “Fairness Package”

18.67 In 1994, we were concerned about poor control over the use of the “Fairness Package” legislation, which provides the Minister with discretionary power to waive all or a portion of interest and penalties. We noted deficiencies in the Department’s policies governing the use of the Fairness Package, in its ability to track requests for relief and decisions granted under the Fairness Package provisions, and in its ability to monitor the circumstances in which the Fairness Package was applied.

18.68 Subsequently, the Department developed enhanced guidelines on applying the Fairness Package and released them in a policy paper entitled “Application of the Fairness Provisions to Interest and Penalty”. A registry and reporting system was implemented to track fairness decisions and account for amounts forgiven under the fairness provisions, including the breakdown of such amounts according to the reason for forgiveness (see Exhibit 18.6).

Audit and Enforcement

Compliance research leads to new audit tools and techniques

18.69 Audit and enforcement are labour-intensive elements of tax administration. Revenue Canada can reach only a small fraction of taxpayers, registrants and others through audit and enforcement. The Department must direct its efforts to the members of the population who pose the highest risk of non-compliance, who represent a significant source of revenue leakage, and against whom enforcement efforts will deter others from non-compliance. To accomplish this, the Department needs sound compliance research to understand the characteristics of that population.

18.70 In 1995, Revenue Canada established the Compliance Research Directorate to act as a centre of expertise on risk assessment and risk management. The Directorate monitors trends in revenues, examines compliance patterns, and conducts studies of factors that affect compliance. The results help in the formulation of compliance strategies and in the creation of computerized tools with which auditors can select the most promising targets for examination and focus on areas that are most likely to reveal non-compliance.

18.71 In response to a recommendation in our 1994 chapter on tax-assisted retirement savings, Revenue Canada set up a system to collect data on the results of its front-end compliance reviews of money purchase and defined benefit pension plans. Analysis of the data showed that certain money purchase plans were low-risk. The Department then adjusted its review process to focus more of its efforts on the high-risk plans. This is an example of how compliance research can improve audit and enforcement.

Auditors adopt focus on industry sectors

18.72 Effective research and targeting of audit and enforcement demand substantial amounts of good information about taxpayers, registrants and others. The risk of tax revenue leakage varies across industry sectors, which means that industry-sector-based information is essential for risk assessment and risk management. Our 1994 audit of GST audit and special investigations revealed that Revenue Canada possessed poor quality and insufficient quantities of information on registrants — in particular, incomplete and unreliable records of registrants’ Standard Industry Classification (SIC) codes.

18.73 In 1995, the Department mounted a project to review the records that were missing SIC codes for registrants. Now, it reports that 95 percent of accounts of registrants whose annual taxable sales exceed \$30,000 (the threshold for mandatory registration) contain a proper SIC code. In addition, auditors are now responsible for adding missing SIC codes when they make an examination. Revenue Canada and Statistics Canada have established a committee to address the need to ensure that SIC codes reliably describe different industry sectors.

18.74 Further improvements in taxpayer/registrant information are on the horizon. Revenue Canada has introduced a common identifier, known as the Business Number, for all corporate income tax, employer payroll source deductions, GST and customs accounts. Having a common identifier should soon make it practical for the Department to draw upon much more of its information — stored in separate computer systems — for use in compliance research or audit selection. A computer-assisted system for selecting GST registrants for audit is now in place. The system uses information from various sources inside and outside the Department.

18.75 The Department is moving away from an audit selection strategy focussed on identifying individual taxpayers/registrants to a strategy focussed on industry sectors. The Department analyses non-compliance by sector or occupation to identify high-risk areas and to develop appropriate actions. Its Underground Economy Initiative, for example, concentrates on the sectors of construction, jewellery, automobile sales and repairs, hospitality, and home renovations.

18.76 Tax Services Offices (TSOs) are setting up teams of auditors, each team to specialize in dealing with a limited number of sectors. In hand with this, an industry sector specialist team of professionals is putting together “sector profiles” containing business, economic, technical, and compliance information relevant to auditors. Drawing upon the experience of TSO staff in this way responds to one of the recommendations we made in 1994.

18.77 Not all of Revenue Canada’s efforts to improve audit selection rely on using computerized systems. Auditors in the Registered Plans Division make use of referrals from, and consultations with, staff of various sections within the Division to identify areas where risk of non-compliance is high.

New strategies aim at improved audit coverage

18.78 Our 1994 chapter on GST audit and special investigations observed that the number of audits carried out was low — lower than the Department had planned. We recommended that enforcement efforts be made more visible.

18.79 Since its administrative consolidation, Revenue Canada reports its performance for all its verification and enforcement programs together. The Department’s 1995-96 Performance Report shows an increase in enforcement resources to 6,871 full-time-equivalent staff, from 5,909 in 1992-93. Over the same period, the Department reports that the total fiscal impact of verification and enforcement activities increased from \$3.64 billion to \$4.48 billion. The Department defines “fiscal impact” as federal and provincial tax (where applicable), federal tax refunds offset or reduced, interest and penalties, and the present value of future tax assessable.

18.80 Revenue Canada is trying to take advantage of administrative consolidation to increase audit visibility and coverage. It is following a strategy whereby auditors who examine a taxpayer/registrant selected for audit of either GST or income tax will review key indicators of performance for the other tax as well. For the very large companies that are subject to Revenue Canada’s Large File Program, an audit of both income tax and GST is done where, in the judgment of the Large File Case Manager, it is warranted.

18.81 In 1994, we also reported that audit coverage of registered pension plans was too low to detect and deter non-compliance. Since then, the Department has increased the number of audits it performs from 127 in 1992-93 to 365 in 1996-97. To attain even wider coverage, Revenue Canada is looking into the possibility of co-operating with the Pension Commission of Ontario to perform joint audits.

18.82 In response to our observation that past service pension adjustments (PSPAs) were not systematically verified, Revenue Canada performed a study to determine the need for a PSPA examination program. It found that a program was needed and has trained staff in order to implement it in 1997-98.

18.83 Tax evasion. Taxpayers are entitled to use legal means to reduce the amount of tax they pay. But when they use illegal means — fraud — to escape paying tax, they are guilty of tax evasion. Out of fairness to the great majority of individuals and businesses who voluntarily comply with the tax laws, Revenue Canada investigates and prosecutes those who are suspected of tax evasion. It also publicizes its successful prosecutions as assurance to honest taxpayers and as a warning to others.

18.84 Our 1994 chapter on special investigations and detection of non-filers noted the Department's concern that the number of referrals to Special Investigations of cases of suspected income tax evasion was much lower than desired. The same year, our chapter on GST audit and special investigations remarked that referrals to Special Investigations of suspected GST evasion cases, although numerous, were of low quality — lacking the substance needed if they were to be developed for prosecution.

18.85 To address these problems, Revenue Canada has given fraud awareness training to more of its auditors and has published additional guidance to auditors on preparing referrals.

Verification program for RRSP contributions needed

18.86 In our 1994 audit of tax assistance for retirement savings, we made a recommendation with which Revenue Canada disagreed at the time and on which it has taken no action.

18.87 We were concerned that taxpayers might make invalid claims for RRSP deductions and that Revenue Canada did not possess information from an independent source that could be used to check for invalid claims. In addition, we were concerned that Revenue Canada had no way to detect taxpayers who attempted to defer tax by sheltering income in an RRSP even though they had not claimed a deduction, perhaps because they had made contributions in excess of allowable limits.

18.88 The Department points out that starting in the 1994 taxation year, taxpayers are required to make additional disclosures on their income tax returns. However, we do not believe that this is an adequate substitute for a verification program aimed at RRSP contributions. We hope the Department will reconsider its position and implement a verification program for RRSP contributions.

Policy and Legislation

Process developed to manage the risk associated with complex legislation

18.89 In 1993, we reported on the use of a resource allowance income tax provision that Revenue Canada estimated could cost \$1.2 billion in lost tax revenue. Revenue Canada had challenged one taxpayer's interpretation of the provision in the courts in the belief that its own interpretation would prevail and the threat to the tax base would be eliminated. However, the courts found in favour of the taxpayer. We pointed out that if the government had moved quickly to clarify the law, a considerable portion of this loss could have been prevented.

18.90 Our observation resulted in an inquiry by the Public Accounts Committee into the government's procedures for managing the risk to the tax base associated with complex legislation. The inquiry was completed and the Committee presented its recommendations to the House in February 1995. In response to the Committee's recommendations, the government has developed a process to act more quickly and reduce the likelihood of similar losses in future.

Issue relating to condominiums has been resolved

18.91 In 1994, we reported that Revenue Canada had failed to resolve an issue that we had first raised in 1992, concerning the ability of condominium corporations to earn tax-free interest income for the benefit of individual condominium owners. Our concern was that this ability arose from an administrative policy established by the Department, and this ability was not available to owners of other types of residential dwellings.

18.92 Revenue Canada has studied the matter and found that the administrative policy was not necessary, since condominium corporations can qualify as non-profit organizations. The information setting out the Department's administrative policy has been cancelled.

Basis for sharing "unapplied taxes" with the provinces and territories not resolved

18.93 In a 1993 audit observation, we reported our concern that payments to provinces and territories participating in the Tax Collection Agreements were being understated because of Revenue Canada's failure to share the balance in one of its accounts.

18.94 Concerned that the balance in the account may have arisen, in part, from bookkeeping errors and therefore was not appropriate to share, Revenue Canada made a significant effort to ensure that only appropriate transactions were recorded in the account. This having been done, the question remains whether the balance in the account ought to be shared.

18.95 It is Revenue Canada's and the Department of Finance's view that only unapplied amounts deducted from employees' earnings are to be shared with the provinces and territories. We believe that the account in question may contain such amounts as well as other amounts that the provinces and territories may regard as shareable.

18.96 We understand that this issue will be discussed with the provinces and the territories in the near future.

Monitoring and Reporting

Management information agreements promise better monitoring and reporting

18.97 Another common theme in many of the audits we followed up was the need for Revenue Canada to collect information that would tell management how the Department is performing in relation to its goals, and that could be used to report to Parliament on how Revenue Canada is fulfilling its mandate. In addition to meeting its own management information needs, Revenue Canada has to supply the Department of Finance, as the steward of tax policy, with the information it needs to judge how well the tax system is achieving the policy objectives it serves. A prime example is information needed to monitor the effectiveness of tax expenditure programs.

18.98 In 1994, we reported the results of our audit of income tax incentives for research and development. We found that Revenue Canada was collecting some, but not all, of the information needed to monitor the incentives for research and development. We also observed that the Department's database on the scientific research and experimental development incentive was not completely reliable.

18.99 In response to the first problem, Revenue Canada modified its Audit Information Management System to capture additional kinds of data. It has also specified features that are to be built into a new system being developed to process corporate income tax returns. Regarding the second problem, the Department has instituted new verification procedures aimed at improving the accuracy and completeness of the information in its scientific research and experimental development database.

18.100 More generally, the Department's Verification, Enforcement and Compliance Research Branch developed management information agreements for each program in the Branch. The agreements define program mandates, objectives, and performance indicators along with the data required to produce them. In addition, the Branch publishes and widely distributes to its staff a volume covering its priorities and achievements, and program information.

Trade Administration

18.101 Canada's trade relations are affected by many government policies and international agreements to which it is a party. Revenue Canada plays a major role in the administration of these policies and agreements. There are many parallels between Revenue Canada's activities in tax administration and those in trade administration.

18.102 In this section, we report the results of our follow-up of our 1994 chapter on customs assessment. That chapter approached trade administration from the standpoint of the assessment of customs duties, including the administration of duty-relief programs. The approach was consistent with the Department's emphasis at that time on revenue generation as part of the government's overall strategy of deficit reduction. It is noteworthy that now, roughly three years later, the emphasis has shifted more toward improving trade data in support of the government's trade development initiatives, one of the Department's concerns even in 1994.

Periodic verification initiative is progressing

18.103 In 1994, we reported that Revenue Canada had recently completed two pilot projects that, among other things, tested the use of periodic verification as an alternative to ongoing review of imports by large importers. Satisfied with the merits of the periodic verification alternative, the Department came up with a plan to audit 128 large and medium importers from 27 industry sectors. As of December 1996, 27 audits had been completed, 68 were under way, and 33 had not begun. The program is to cover 32 percent of the total import value for duty.

18.104 As a complement to on-site periodic verification of importers, Revenue Canada envisages doing a less extensive desk verification of enough other importers to bring the coverage up to 40 percent of total value for duty of imports. This work has yet to begin. In the longer term, the Department intends to identify other industry sectors for review, based on its own research and on Canada's international business development plan.

End-use and country-of-origin audit concerns have been addressed

18.105 An end-use provision reduces or eliminates the duty payment if certain conditions are met. In 1994, we were concerned that not enough end-use audits were being done. A new tariff scheduled for implementation on 1 January 1998 will greatly reduce the number of end-use codes and thereby reduce the need for end-use audits. In the meantime, Revenue Canada has reorganized the end-use audit function and has tied it to the periodic verification initiative. It believes those actions have improved the scope and effectiveness of these audits.

18.106 We expressed similar concern about the low number of country-of-origin audits. These are audits to determine that a country from which goods originate is entitled to a preferential tariff rate under a free trade agreement. By increasing the number of staff devoted to country-of-origin audits, Revenue Canada has been able to increase the number of audits it performs. In 1994, we reported that the Department had carried out 40 audits in the five years ending 31 March 1994. Departmental records show that in the three subsequent years it completed 36 audits.

Small importer strategy formulated and implementation started

18.107 Ninety-one percent of importers account for just 6 percent of the total import value for duty. They tend to import goods less than once a week. The risk is low that any errors by these small importers would significantly distort trade data.

18.108 Our 1994 chapter noted that Revenue Canada's New Business Relationship (NBR) initiative was heavily focussed on large importers, and that a strategy was needed to deal with other importers. Believing that it would be inefficient to apply a periodic verification strategy to small importers, the Department has chosen instead to use a client service strategy as part of the NBR initiative, involving simplified trade data requirements, easier payment terms and methods, wider access to electronic commerce, and more effective programs of client assistance and information. To date, the client service strategy for small importers has been developed and the Department reports that supporting initiatives are to be undertaken during 1997-98.

DEPARTMENT OF FINANCE

Observations

Tax Assistance for Retirement Savings

18.109 The Department of Finance is responsible for the design and management of the program of tax assistance for retirement savings (TARS). Management of the program involves monitoring, evaluating and reporting on its costs and effectiveness, and recommending changes as appropriate.

Improved cost estimates are expected

18.110 In response to our 1994 suggestion that it provide information on the estimated costs, results and workings of the TARS program, Finance says that it will be providing historical data and a five-year forecast of the tax expenditure in an upcoming tax expenditure report. We also advocated supplementing cash flow estimates of the tax expenditure with estimates based on the present-value method and other approaches. The Department has made present-value estimates of the cost of the TARS program, which it has submitted for review by experts from outside Finance.

Slow progress on evaluation studies

18.111 In 1994, we noted the Department's plan to complete nine evaluation studies of the TARS program. It has since changed its plan. Four of the proposed studies are being combined into one and a preliminary report is expected at the end of the summer, along with a report on a survey of compliance issues. Work on the other four studies is to begin in the fall.

18.112 Our remaining recommendations had to do with conducting further evaluation studies that were not planned at the time of our audit. Finance tells us that these are being addressed in part and that we will be given the results of this work in the future.

Income Tax Incentives for Research and Development

Evaluation studies and cost estimates are forthcoming

18.113 This 1994 chapter also focussed on Finance's role in monitoring tax incentives for scientific research and experimental development (SR&ED) and in accounting for their costs. We saw a need for more thorough and systematic monitoring to allow for better accounting of projected and actual costs and results.

18.114 The Department indicates that it is now finalizing a report on the findings of an evaluation of the income tax assistance for scientific research and experimental development. In addition, in the upcoming report on tax expenditures it will be publishing estimates and forecasts of the costs of the SR & ED tax credits.

Other Observations

Technical deficiencies in law related to foreign affiliates and taxpayer migration corrected

18.115 In our 1992 Report, we observed that tax arrangements for foreign affiliates were costing Canada hundreds of millions of dollars in lost revenues. After a detailed inquiry, the House of Commons Standing Committee on Public Accounts submitted recommendations to the Minister of Finance in April 1993. The February 1994 Budget announced changes to the rules governing the way foreign affiliates are taxed. The amendments, now in law, incorporate most of the recommendations of the Public Accounts Committee.

18.116 In May 1996, we reported serious concerns about the administration of the *Income Tax Act* involving the tax-free movement out of Canada of at least \$2 billion in assets held in family trusts. This report generated a great deal of attention by the government and by two committees of the House of Commons. In response to House of Commons Finance Committee recommendations, in October 1996 the Minister of Finance announced major changes to the income tax rules for persons (including trusts) who leave Canada. The proposed changes are intended to ensure that taxpayers who move or transfer property from Canada will remain subject to Canadian tax on their capital gains. In making the announcement, the Minister acknowledged the Auditor General's role in drawing attention to the issue and the Finance Committee's role in recommending corrective action. He said, "This is a textbook case of the system working as it should."

18.117 In 1994, we reported that a number of companies in the financial sector had made claims under the scientific research and experimental development (SR & ED) provisions of the *Income Tax Act*, amounting to over \$300 million. The claims were for software development, and it was unclear whether the SR&ED provisions were meant to apply to this kind of item. At one point, the Minister of Finance produced draft legislation aimed at denying claims for software developed by companies in the financial sector. The draft legislation was later withdrawn in favour of administrative action by Revenue Canada to deny such claims.

18.118 Our 1995 chapter on the air transportation tax drew attention to a possible loophole involving charter air transportation and suggested that Finance may need to re-examine the legislation. In connection with the privatization of Canada's air navigation system, Parliament has since passed legislation that will abolish the air transportation tax in the fall of 1998. In view of this development, we expect no further action by Finance on this matter.

About the Follow-up

Objective

To assess, for 15 audits conducted between 1992 and 1996, the extent to which OAG recommendations, applicable Revenue Canada action plans and PAC recommendations have been addressed by Revenue Canada and the Department of Finance.

Scope

We followed up on the 15 audits listed below, related PAC recommendations, and applicable departmental action plans.

1992	Chapter 2	Audit Note on Tax Arrangements for Foreign Affiliates* ³
1993	Chapter 3	Audit Note on Resource Allowance Income Tax Provision ^{*1}
	Chapter 3	Audit Note on Tax Collection Agreements ²
	Chapter 3	Audit Note on Overdue GST ¹
	Chapter 20	Advance Income Tax Rulings: GST Rulings and Interpretations ¹
1994	Chapter 3	Audit Note on Condominium Corporations ¹
	Chapter 28	Customs Assessment Activities ¹
	Chapter 29	Collecting Income Tax Debts (PAC 8th Report) ¹
	Chapter 30	GST: Audit and Special Investigations (PAC 8th Report) ¹
	Chapter 31	Ensuring Fairness of the Income Tax System: Detection of Non-Filers and Special Investigations (PAC 8th Report) ¹
	Chapter 32	Income Tax Incentives for Research and Development (PAC 9th Report) ²
	Chapter 33	Tax Assistance for Retirement Savings (PAC 9th Report) ²
1995	Chapter 16	Air Transportation Tax ²
	Chapter 25	The New Regime for Processing Income Tax Returns ¹
1996	Chapter 1	Audit Note on Moving Assets out of Canada* ³

¹ These audits involved follow-up in Revenue Canada only

² These audits involved follow-up in Revenue Canada and the Department of Finance

³ These audits involved follow-up in the Department of Finance only.

Approach

Revenue Canada and, where applicable, the Department of Finance provided status reports presenting management's assessment of the departments' progress in implementing their action plans and in responding to our recommendations and those of the PAC for each of 12 audits. We used the status reports as a base to carry out the follow-up. For the other three audits*, we did not request status reports but followed up on actions taken by performing review procedures ourselves.

In order to draw conclusions about the plausibility of management's assertions contained in the status reports, we collected data on a selective basis and performed other review procedures.

Follow Up Team

Michael Adibe
Nabi Baksh
John Pritchard

For information, please contact Jim Ralston, the responsible author.

Chapter 19

Transport Canada

The Commercialization of the
Air Navigation System

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Transport Canada

The Commercialization of the Air Navigation System

Assistant Auditor General: Shahid Minto
Responsible Auditor: Hugh A. McRoberts

Main Points

19.1 On 31 October 1996, in exchange for a payment to the Crown of \$1.5 billion, a substantial legislated monopoly in perpetuity for the operation of Canada's civil air navigation system was transferred to NAV CANADA, a private not-for-profit corporation created in 1995 to receive and operate the system.

19.2 Transport Canada did not fully segregate the air navigation system elements that were to be privatized before entering the sale process. It developed a number of estimates of the system's value, but did not obtain a formal valuation opinion from a qualified independent professional. Nor did it obtain any external assurance as to the reliability of the financial information and results on which it was basing its decision on the sale.

19.3 The Department used both going-concern and net book value approaches to valuing the system. Although the air navigation system was sold as a going concern, the Department reconciled the "purchase price" to a valuation of the system based on an "adjusted" net book value. In our opinion, that was not an appropriate method of valuation in these circumstances. "Due regard to economy" does not mean that the purchase price must equal the valuation; but it does mean that the value must be known and that any difference should be explained.

19.4 The government had directed Transport Canada to receive fair market value for the transfer of the air navigation system to a not-for-profit entity; the Department agreed to transfer the air navigation system for a negotiated payment of \$ 1.5 billion, approximately \$1 billion less than the entity's going-concern value of \$2.4 billion estimated by the Department's financial advisors.

19.5 The costs of transferring the air navigation system to the not-for-profit corporation were significant. Nevertheless, Transport Canada did not identify separately the cost associated with pension transfers, currently estimated at between \$145 million and \$275 million.

19.6 We are concerned about the Department's lack of justification for entering into a sole-source contract with its principal financial advisor.

19.7 We audited some elements of Transport Canada's oversight of the air navigation system. We did not audit the safety of the system and provide no opinion on it. We found that the legal and regulatory foundations for the regulation of NAV CANADA have been established and the Department has very recently approved its Policy Framework for the Safety Oversight of Canada's Air Navigation System. Nonetheless, there are important matters of risk, data, and audit and inspection that must be resolved before Transport Canada's regulatory regime can be said to be fully operating. The Department is aware of these issues and is in the process of drafting action plans and taking steps to deal with them.

19.8 We are concerned that until Transport Canada makes significant progress in implementing its performance-based regulatory regime, it will not be in a position to have full assurance of NAV CANADA's compliance with the safety regulations governing the air navigation system. Although it has indicated that it would be aware of any problems that existed, the Department has yet to conduct its first audit or inspection of NAV CANADA's operations.

Introduction

19.9 On 31 October 1996, in exchange for a payment to the Crown of \$1.5 billion, the operation of Canada's civil air navigation system was transferred to NAV CANADA — a private not-for-profit corporation created to purchase and operate the system. NAV CANADA is to operate independently of the government except for certain clearly defined areas such as safety and services to remote and northern communities, and is intended to become financially independent of the government after two years. This transaction was authorized by the passage in June 1996 of the *Civil Air Navigation Services Commercialization Act*.

19.10 In the past, two major transportation Crown corporations — Air Canada and Canadian National Railways — were privatized through stock flotations. However, this was the first time that a major operational arm of a government department was transferred by private contract. This was a large and complex transaction involving significant amounts of money and was done in a relatively short time. Given the unusual nature of the transaction and the likelihood that other divestitures may occur in the future, we decided to report on it.

The civil air navigation system

19.11 The civil air navigation system provides civil air traffic control, flight information services such as weather briefings, and a network of navigational aids. Collectively, the various elements of the system provide for the safe and orderly flow of aircraft in Canadian airspace and in those parts of international airspace for which Canada is responsible. Air navigation services are delivered through area control centers, air traffic control towers, flight service stations and a national radar and communications system.

Decision to divest

19.12 On 22 February 1994, the federal Budget included a proposal to study the commercialization of the air navigation system. During the ensuing year, the Department prepared a series of consultation documents and, working with affected government departments, held consultations with all sectors of the aviation community. As the consultations progressed, the option increasingly favoured was the transfer of the system to a not-for-profit corporation that would be created to operate it.

19.13 In the 27 February 1995 Budget, the Minister of Finance announced the government's intent to proceed with the commercialization of the air navigation system. Transport Canada was to achieve this result by as early as possible in the 1996-1997 fiscal year. Initially, 1 April 1996 was set as the target.

Transport Canada's Commercialization Model

Birth of the not-for-profit corporation

19.14 On 26 May 1995, NAV CANADA, a private not-for-profit organization, was incorporated under Part II of the *Canada Corporations Act* as a non-share capital corporation. By-laws were drafted to establish the new entity's corporate structure and governance requirements following the government's direction. Transport Canada entered into reimbursement agreements with NAV CANADA, specifying that if the transaction was not successful, the government would become liable for the purchaser's eligible expenses. The agreements ended on the transfer date and the costs incurred were borne by NAV CANADA.

19.15 Accountability and corporate governance. NAV CANADA's incorporation documents established the legal and accountability framework for its governance. It was formed with four members: one appointed by the federal government, two appointed by user groups, and one appointed by the unions representing air navigation system employees. Corporate governance is exercised through a 15-member Board of Directors; 10 are nominated by the four appointed members forming the corporation and they, in turn, nominate five more, one of whom is the President. The Board's members cannot be active government officials, politicians, significant suppliers, clients or users of the system.

19.16 Role of the federal government. The Government of Canada continues to have a significant role in the air navigation system. It is responsible for regulating it and overseeing its safety. It may also review changes in revenue structure and rates, and it is responsible for deciding on northern and remote services, and appointing a member to the corporation.

19.17 Monopoly. The *Civil Air Navigation Services Commercialization Act* provides NAV CANADA with a substantial legislated monopoly over the provision of civil air traffic control services and aeronautical information services in perpetuity, as long as it meets its obligations under the Act. In return, it is expected to offer these services in a safe and efficient manner that meets the needs of Canadians and fulfils Canada's international obligations.

19.18 Financial independence. NAV CANADA is financially responsible for the operation, maintenance and capital requirements of the Canadian air navigation system. To that end, the legislation gives NAV CANADA the right to recover all of its costs through user charges. The primary sources of revenue for the system when it was operated by Transport Canada were the Air Transportation Tax and, since November 1995, international overflight charges. By the end of the second year after transfer, NAV CANADA is to have introduced terminal charges and domestic en route charges in addition to increasing international overflight charges. The government provided for monthly grants to a maximum of \$ 1.44 billion to be paid to NAV CANADA during the first two years until it has put its charges in place. These grants are approximately equal to the government's anticipated revenues from the Air Transportation Tax. As NAV CANADA introduces its charges, the government is expected to revise the ticket tax rate until the end of the second year after the transfer, at which time it will be repealed.

19.19 Transport Canada's model is unique. Other countries have moved in the direction of separating the operation of their air navigation systems from government. Some, most notably Australia and New Zealand, have gone so far as to set up the air navigation system operator as an entity similar to a Crown corporation. The United Kingdom has also set up a separate air navigation service organization and plans to privatize it in the near future through a stock flotation.

19.20 At the time of writing, however, Canada is the only major country to have taken the extra step of transferring the operation of its air navigation system to the private sector. The international aviation community is watching the Canadian experience with interest.

Objectives for commercialization

19.21 According to Transport Canada, the government's objectives in commercializing the air navigation system were to have a system able to respond better and more quickly to user needs, to achieve more rapid system improvements in internal and transportation efficiency, to eliminate the system's dependency on taxpayers and to operate the system in a businesslike way.

Timetable for transfer

19.22 In November 1995, following negotiations during the early fall, the government approved the transfer of the right to operate the civil air navigation system to NAV CANADA for a payment of \$1.5 billion. A broader

agreement-in-principle for the transfer was reached on 8 December 1995 and the agreement to transfer was finalized on 1 April 1996. Although several delays were encountered during the sale process due to the complexity of the transaction, on 31 October 1996 the government received a payment of \$1.5 billion and transferred the operating rights and assets of the civil air navigation system to NAV CANADA. Due in part to the speed with which the process was accomplished, a series of undertakings by Transport Canada remained to be done — among other things, to identify and transfer all relevant items of intellectual property, to complete the conveyance of lands, and to complete the assignment of contracts. Exhibit 19.1 shows the timetable of the commercialization process.

Exhibit 19.1

Chronology of Events Leading to Air Navigation System Transfer

1991-93	Groups of Air Navigation System (ANS) users, employee unions, Transport Canada managers, a Ministerial Task Force on Aviation Matters, the Royal Commission on National Passenger Transportation and the aviation community in general voiced the opinion that the ANS was underfunded, hampered by government policy, and not meeting the needs of the aviation community. There was a need for change.
Late 1993	Transport Canada established a project team to study the feasibility of ANS commercialization, with five discussion papers being prepared.
Late 1993	Establishment of a Steering Committee consisting of representatives from Transport Canada, other departments and central agencies.
February-March 1994	Announcement by Government that Transport Canada would study options for the commercialization of the Canadian civil air navigation system.
April 1994 to Jan 1995	Establishment of the Commercialization Advisory Committee made up of representatives from government, user groups, industry, unions and the public.
Spring through fall, 1994	Extensive consultative process conducted across the country based on the five discussion papers to allow all interested parties to comment. Conducted with aviation community, interested parties, clients and employees.
February 1995	Consensus by Advisory Committee to support the not-for-profit option, and disbanding of Advisory Committee.
February 1995	Guiding principles and recommendations, developed in collaboration with the Steering and Advisory Committees and officials from other government departments, were submitted to Cabinet for approval.
February 1995	The Budget speech announced the approval of the recommendation of the Minister of Transport, supported by the Advisory Committee and the majority of ANS bargaining agents, that the ANS be commercialized by means of a sale to a not-for-profit corporation.
May 1, 1995	Appointment of Chief Negotiator and Deputy Chief Negotiator, establishment of project team.
May 26, 1995	NAV CANADA incorporated as a corporation without share capital under Part II of the <i>Canada Corporations Act</i> for the purpose of acquiring, developing, operating and maintaining the ANS.
July 1995	Negotiations began.
September 8, 1995	Transport Canada, NAV CANADA and the nine employee bargaining agents signed a tripartite Memorandum of Understanding on human resources expressing strong commitment to equivalency for employees.

December 8, 1995	An agreement-in-principle was signed with NAV CANADA to sell the ANS for \$1.5 billion net.
March 14, 1996	Introduction of the <i>Civil Air Navigation Services Commercialization Act</i> into the House of Commons by the Minister of Transport.
April 1, 1996	The formal contract, the Agreement to Transfer, was signed by Transport Canada and NAV CANADA.
June 20, 1996	The <i>Civil Air Navigation Services Commercialization Act</i> received royal assent.
October 31, 1996	The deal closed, with NAV CANADA assuming responsibility for operating the ANS on the official transfer date, November 1, 1996.

Source: Transport Canada

Focus of the Audit

19.23 Details on our scope and audit objectives are included in the section **About the Audit** at the end of the chapter. We did not audit the decision to transfer or look at the negotiation process, but focussed on the implementation of the transfer. We assessed whether Transport Canada exercised due regard to economy in the sale process; established adequate procedures to protect the interests of the Crown during the transfer process; disclosed the full costs of the commercialization; employed appropriate contracting practices in acquiring financial advisory services; and put in place adequate procedures to regulate the safety of the system and receive assurance of its safety.

19.24 The International Organization of Supreme Audit Institutions, through its subcommittee on privatization, has examined the international experience with privatization. Our review of the INTOSAI work and our discussions with others who have experience in divestiture lead us to conclude that in transfers of government services, the risks inherent in these transactions are reduced when the process is done in two phases. First, the operation to be divested is carved out of government operations and commercialized as a government-owned entity. There follows a period of operational stabilization in which the new entity puts in place the management and financial structures it needs to operate on a stand-alone basis. Only when the new organization is clearly defined and operational would a government elect to move the function to a private corporation. Exhibit 19.2 describes the most current and pertinent example, the yet-to-be-completed privatization of the National Air Traffic Service (NATS) in the United Kingdom.

Exhibit 19.2

The Privatization of the Air Navigation System in the United Kingdom

In 1972 the British government established the Civil Aviation Authority (CAA) as a nationalized industry — combining features of a special operating agency and a Crown corporation for regulation. Over a number of years, the National Air Traffic Service (NATS) — the operator of the air navigation system — was increasingly separated from the regulatory part of the CAA, culminating, in 1996, in its formation as a limited company wholly owned by the CAA. The effect of this was twofold: first, the regulatory regime was established and stabilized, making possible the development of a clear distinction between the operator and the regulator, each with well-defined roles and responsibilities. Second, the NATS organization was put on a sound financial footing and issued its first set of audited financial statements this year. It is expected that NATS will be privatized through a stock flotation within the next year.

19.25 In addition to privatizing some Crown corporations in recent years, the Government of Canada has also transferred a special operating agency, the Canada Communication Group, to the private sector. In that case, the government followed a two-phased approach. Such an approach was not formally considered by the government in setting out the commercialization options for the air navigation system.

Observations and Recommendations

Valuation of the Air Navigation System

19.26 In any sale, due regard to economy requires that the seller enter the process with a clear understanding of the entity to be sold and its value. This information then becomes a benchmark for reference during the sale, against which the seller can assess the buyer's proposals. Once the sale is completed, the seller can be held to account for the variance (positive or negative) between the sale price and the valuation. We emphasize that "due regard to economy" does not mean that the purchase price must equal the valuation; rather, it means that the value must be known and any difference should be explained.

19.27 Accordingly, in assessing whether the Department exercised due regard to economy in carrying out the sale of the air navigation system to NAV CANADA, we focussed our audit work on what, in our view, was the key issue: valuation.

The entity to be transferred was not fully segregated

19.28 In any such transaction, a clear and comprehensive definition of what is to be sold is important because the usefulness and quality of the valuation depends on how fully the entity is defined.

19.29 Transport Canada conducted a conceptual exercise in 1994 to determine the financial position and financial results for the air navigation system were it to be commercialized. It compiled estimates of the system's expenses and revenues by making a large number of tentative assumptions. However, it did not obtain any independent assurance as to the reliability of the financial figures resulting from the conceptual exercise.

19.30 Transport Canada informed us that it defined several major elements of the sale with NAV CANADA during the negotiation process. Although it may be common to have some of the elements of sale defined at that stage, we found that the impact of many of these elements on the value assigned to the system was potentially quite significant. They included the identification of major revenue streams and of designated employees, the duration of the monopoly right, development of the regulatory framework, assignment of major capital projects, actuarial assumptions for employee severance pay and pension liabilities, and land assessment for ownership and environmental liabilities.

19.31 Transport Canada has made it clear that throughout the sale process the reliability of the inventory and asset management information system was questionable and that any figures provided were always covered by the statement that they were gross estimates. In the spring of 1996, the Department began to execute procedures to improve the accuracy and reliability of the information.

Transport Canada's "lessons learned" study

19.32 The Department conducted a study to identify lessons learned from its own and the government's overall approach to the commercialization of the air navigation system, and to identify key strategic issues for similar undertakings in the future. The Department was to prepare an interim and a final report. On 31 March 1996, it produced an interim report on the lessons learned during the process of negotiating the transfer.

19.33 One of the lessons was the benefit of clearly identifying and segregating assets prior to entering negotiations. The study also concluded that if an entity being sold resides within a larger organization, as was the case for the air navigation system, and if there is time, consideration should be given to separating the entity and having it operate on its own for a certain period of time as this helps to improve the understanding of exactly what is

being sold. Although this interim report identified significant lessons that would have warranted a final report upon completion of the transfer, we were informed by the Department that there would be no final report. This is unfortunate because, in our view, the study was a positive step by the Department to identify key lessons from this transfer that could be used in preparing for other government divestitures.

19.34 These lessons were reinforced by the Department's principal financial advisor who wrote indicating that the transfer involved some potential risks, caused in part by the uniqueness of divesting directly out of a government department instead of through a separate government-owned entity. Further, the financial advisor expressed concern that the air navigation system was not a self-contained commercial entity with segregated financial reporting and management information systems, and accordingly there were no audited financial statements upon which the potential purchaser could rely for its valuation and purchase decisions.

Transport Canada's valuation lacked key documentation

19.35 Before the transfer, Transport Canada valued the air navigation system using both going-concern value and net book value approaches.

19.36 We looked at the reliability of the financial information and the documentation for the range of values used by Transport Canada in arriving at the value of the air navigation system.

19.37 We found that many of the key numbers used to determine the going-concern and net book values were based on unaudited historical financial information, on which Transport Canada neither sought nor received external assurance.

19.38 The Department and its financial advisors did extensive analyses in preparing for the sale process and the results of some of this work are contained in documentation made available to us. However, critical gaps in the documentation made it impossible for us to fully review much of this information. For example, many of the underlying assumptions and forecasts used in determining the air navigation system's value were not documented. We requested working papers and analyses for revenue assumptions, operations and maintenance expenditures, capital expenses, financeability, the assumed growth rates and rate charges for the revenue assumptions, assumed efficiency rates, number of employees, salaries and benefits, the forecast capital expenditure breakdowns, etc. The Department was unable to provide us with a sufficient set of working papers supporting the assumptions used in its key valuation models. Such supporting information would have provided, among other things, the details and rationale behind the numbers used in Transport Canada's key going-concern models. The Department has explained to us that because of the way the negotiations proceeded, later changes in the assumptions were not documented.

19.39 The Department was similarly unable to provide us with the rationale and support for the net book value it arrived at, the reasons for excluding capitalized interest and the evidence for other adjustments.

19.40 Due to the lack of supporting documentation, our Office is unable to comment on the reliability of the valuations arrived at by the Department.

19.41 **In future divestitures, the government should properly document its key valuation models and maintain a complete set of working papers to support the assumptions used in determining value.**

Transport Canada's going-concern valuations

19.42 A going-concern value is generally expressed as a range of values based on anticipated future financial results. This is normally quantified using a discounted net cash flow.

19.43 In the summer of 1994, Transport Canada entered into an agreement with its principal financial advisor for services that included assessing the potential value of the system. Although the financial advisor determined the potential value for different entity types, in this section our discussion focusses on the valuations prepared for the selected form, the not-for-profit entity.

19.44 Initial going-concern valuation. Before entering into the sale process, the Department and its financial advisor developed an initial going-concern valuation of the air navigation system of between \$1.0 billion and \$1.3 billion. However, this exploratory valuation did not adequately consider, among other things, the full impact of introducing overflight charges, a key revenue stream.

19.45 Subsequent work. During the months that followed, as Transport Canada proceeded to define more precisely the various components of what it was selling, the Department and its principal financial advisor significantly revised the estimates of the value of the air navigation system. Most notably, the planned introduction of the overflight charges in late 1995 increased the revenue potential of the entity by more than \$300 million a year. This could, over time, bring the gross revenue potential from about \$700 million to over \$1 billion per year.

19.46 In assessing an entity's going-concern value, it is important to have the value tested in the financial markets. In this case, because the corporation was intended to be financed entirely through debt, the test of that market was to help determine the amounts investors were willing to risk in the venture. This test of the market, known as assessing the financeability of the entity, provides an additional indication of whether the assessed value is reasonable.

19.47 On 1 August 1995, Transport Canada hired a second financial advisor to review the earlier financial models used to determine the value of the air navigation system and to assess the financeability of the entity, particularly in the United States and international markets.

19.48 The financial advisors' joint valuation: \$2.4 billion. In late September 1995, the Department's two main financial advisors made a joint presentation to senior officials of Transport Canada. They presented a number of possible valuations based on differing assumptions about the conditions of sale. The most critical of these was the issue of whether the monopoly on services would be granted for a limited time period or in perpetuity. Accordingly, estimates of value were prepared based on terms of 10, 20 and 30 years. The 30-year term effectively approximates in value a monopoly in perpetuity. These models showed clearly that a grant of monopoly for a more limited fixed term would result in a very sharp decline in estimated value. Ultimately, the Department decided to transfer the monopoly in perpetuity. The estimated value given by the financial advisors for the 30-year (perpetual) monopoly was \$2.4 billion. This estimate incorporated both going-concern and financeability considerations.

19.49 To the extent possible, we reviewed the model used to generate this estimate. We found that the assumptions used were conservative (that is, they tended to underestimate the value of the system). For example, the model was based on an assumption that the rates charged by the corporation, and its revenues, would begin to fall as early as the fourth year and would continue to decline thereafter. The model also assumed less-rapid recovery of full costs than is permitted in the legislation or planned by NAV CANADA based on its prospectus. The estimate also assumed that the corporation would be fully taxable; as a not-for-profit corporation, NAV CANADA is not currently taxable. Thus, the estimate of \$2.4 billion on a going-concern basis, in light of the actual terms and conditions of the transfer and based on the documentation available to us, could materially understate the value of the civil air navigation system.

19.50 Although the financial advisors did not provide a valuation opinion on that estimate, or any other, based on the documentation available to us the \$2.4 billion estimate of value became the figure that was central to subsequent advice provided to the Department.

Net book value, an inappropriate measure

19.51 As early as 1994, Transport Canada had estimated that the net book value of the air navigation system by 1 April 1996 would be \$2.6 billion. The net book value of an entity is determined by accumulating all the costs, including financing costs incurred to acquire the assets (such as land, buildings, and systems) that are used in generating revenues, net of depreciation and liabilities.

19.52 The net book value is generally not used to measure the value of an organization to be sold or transferred as a going concern. While the information is useful in preparing for a sale, it provides little or no information about the cash flow generation potential of the assets, which, in a going concern, forms the basis of their value. We reviewed the government's estimate because it was the benchmark against which the Department reconciled the "purchase price", and because of its relevance to the Department's objective of transferring the full cost of the system from taxpayers to the users of the system.

19.53 In October 1995, the Department of Finance informed Transport Canada that it believed that the government should be recovering its investment in the air navigation system by asking for a transfer value equal to the book value. It noted that the financial advisors had stated that it was reasonable and defensible to use a net book value of \$2.6 billion, including capitalized interest, as the transfer value of air navigation system assets. In its support for this conclusion, Finance indicated that Transport Canada had used the net book value of \$2.6 billion in recent international discussions to justify the introduction of overflight charges. It concluded by saying that in its view the net book value of \$2.6 billion, including capitalized interest, should be the basis for further discussions.

19.54 In reply, Transport Canada suggested that in its view the net book value was \$1.9 billion. It arrived at this figure by removing from the higher figure the capitalized interest associated with the major Crown projects, such as RAMP (Radar Modernization Project), that had developed the technical infrastructure of the air navigation system. Because the commercialization legislation and applicable ICAO (International Civil Aviation Organization) guidelines enable NAV CANADA to recover all costs including capitalized interest through user fees, and because those interest costs were a real part of the cost of those projects to the Crown, the reduction should not have been made. Moreover, our review of the available documentation leads us to conclude that the adjusted net book value used by the Department is understated by at least \$140 million.

19.55 We asked Transport Canada for its rationale for using the net book value as the basis for determining the value of the commercialized air navigation system. The Department informed us that it had focussed on net book value based on advice that ICAO cost recovery guidelines had established this figure as a ceiling on recoverable costs. We have reviewed the applicable ICAO guidelines and cannot find support in them for this conclusion.

19.56 The importance of using going concern as the basis for commercial valuation was further demonstrated by NAV CANADA in its 1996 prospectus, in which it made a preliminary allocation of only \$100 million of the purchase price to the air navigation system assets, valued by Transport Canada at \$2.6 billion. NAV CANADA also allocated only \$36 million of its purchase price to the liabilities it assumed. The remaining \$1.481 billion of the purchase price was allocated to the monopoly right or intangible entitled "air navigation rights".

Amount of transfer

19.57 On 31 October 1996, Transport Canada received a payment of \$1.5 billion from NAV CANADA for the transfer, after extensive negotiations between the government and the purchaser.

19.58 Exhibit 19.3 shows how the Department compared the price it received with its "adjusted" net book value of \$1.9 billion. As we have noted, in our view neither the adjusted net book value nor the net book value of \$2.6 billion by themselves represent appropriate bases for valuation in the circumstances of this transaction.

Exhibit 19.3

Transport Canada's Reconciliation of the Purchase Price by Reference to Adjusted Net Book Value

Purchase price	\$ 1,500,000,000
Costs assumed by NAV CANADA	
Employee Liabilities/Grievances	40,000,000
ERI/EDI and Transition Liabilities ¹	150,000,000
Obligations for Foreign Military and State Aircraft Charges ²	130,000,000
Effective Gross Proceeds³	\$ 1,820,000,000
Net Book Value ("adjusted")⁴	\$ 1,900,000,000

¹ERI and EDI represent Early Retirement Incentive and Early Departure Incentive respectively. This represents the highest value in the range of the actuarial estimates of possible costs that NAV CANADA would incur if it used these tools to achieve staff reductions. The use of this estimate overstates the case.

²This figure has not been audited; no evidence to support it was received from the Department.

³This tabulation does not contain any of the costs to the Crown of the transaction.

⁴This figure is intended to represent the net book value of the assets of the air navigation system. The Department has adjusted it to remove the value of capitalized interest. However, capitalized interest is a legitimate part of the cost of acquiring these assets, and is a fully recoverable cost regardless of who is running the system. Its omission understates the net book value of the assets by approximately \$700 million. Additionally, our review of the available documentation leads us to conclude that the adjusted net book value is understated by at least a further \$140 million.

Source: Transport Canada

19.59 The more appropriate basis for estimating value is to use a going-concern approach. As discussed earlier, the going-concern estimate of value that was based on assumptions most closely approximating the conditions of transfer was a conservative estimate of \$2.4 billion. Additionally, we were informed by Transport Canada that financeability alone suggested that the market would have been prepared to support much higher values.

19.60 The Department did not request or receive from its financial advisors any formal statement of their valuation of the entity, despite the amount of money involved and the government's requirement for assurance.

19.61 As part of a professional and independent valuation opinion, the Department would also have received assurance on the reliability of the financial and other information used in preparing the valuation. However, the Department explicitly specified in the contract with its principal financial advisor that such assurance did not have to be provided. We believe that in a transaction this large and complex, carried out with only one potential purchaser — and where the negotiations were taking place between the Department and an entity represented by some of the same people who had previously advised the Department on how the transfer should be arranged — the Department ought to have sought independent assurance through a formal valuation opinion.

19.62 In making significant divestitures, the government should ensure that prior to entering negotiations, it receives a formal valuation opinion from a qualified independent professional on the value of what is being sold.

Incomplete communication to government on value

19.63 Before the sale process began, the government approved Transport Canada's proposal to commercialize the air navigation system and directed the Department to obtain fair market value, as determined by its financial advisors and approved by the Department of Finance.

19.64 In November 1995, Transport went to the government seeking approval for its agreement-in-principle with NAV CANADA, including approval for a transfer price of \$1.5 billion. Although going-concern valuations had been produced, Transport Canada reconciled for the government the value to be received from the transfer (including the price) by comparing that amount to the adjusted net book value (see Exhibit 19.3). We received no evidence to suggest that, at that time, the financial advisors supported the adjusted net book value approach, or that they thought that this value in any way represented a proxy for fair market value. No information on the results of the going-concern valuations was formally presented to the government in seeking its approval of the price.

Potential subsidy to aviation industry

19.65 In the making the decision to transfer the air navigation system to a not-for-profit corporation, the government accepted two interrelated financial objectives. First, the government wanted to end dependency on the taxpayer and the objective was to have the users pay the full cost of operating the system. Second, the Department was directed to achieve a price that represented fair market value. In light of these objectives, we believe the negotiation of a purchase price that was significantly lower than the most reasonable valuations (on either a going-concern or net book value basis) represents a substantial indirect subsidy to the aviation industry, which was not properly authorized and disclosed. If one uses either the Department's final going-concern valuation of \$2.4 billion or the net book value of \$2.6 billion as the best available estimates of fair market value, then the magnitude of the subsidy could range up to a billion dollars.

Lack of due regard to economy

19.66 The Department failed to exercise due regard to economy in determining the value of the air navigation system. Exhibit 19.4 shows basic steps that we believe would contribute to due regard to economy in future government transfers. Further, based on the documentation available to us, we conclude that the Department did not disclose to decision makers information on the potential going-concern value of the air navigation system.

Exhibit 19.4

Recommended Process for Future Government Transfers

Basic steps that would contribute to ensuring due regard to economy in determining value

1. Prior to entering into the sale process, the vendor should clearly define the entity to be sold, through the identification and segregation of all assets and liabilities, personnel and financial results.
2. Prior to entering into the sale process, the vendor should know the approximate going-concern value of what is being sold.
3. The vendor should use a valuation method that is consistent with the nature of what it is selling.
4. The vendor should have an independent and qualified financial advisor for the determination of the value of what is being sold.
5. The vendor should set a minimum floor price prior to entering into the negotiations.
6. The vendor should obtain a formal valuation opinion from a qualified professional on what is being sold.
7. The valuation should be based on information that is materially correct and complete.

8. The valuation should be revisited if there is a long period of time between the performance of the valuation of what is being sold and the date of the agreement to transfer and the date of the physical transfer.
9. The vendor should provide complete and accurate information to Parliament with respect to what is being sold.

Note: The above steps will contribute to ensuring due regard to economy in the determination of the value of what is being sold. It should be noted, however, that a proper valuation can be carried out only after the vendor defines clearly what is being sold.

Department's comments: Transport Canada's comments on this section can be found at the end of this chapter beginning at page 19-28.

Significant Costs of Transferring the Air Navigation System

Accountability to Parliament

19.67 Currently, there is no requirement for the government to account to Parliament for the financial and substantive results of divestitures. The costs of transferring the air navigation system to the not-for-profit corporation were significant — we estimate them at between \$245 million and \$375 million — but were not consolidated and reported to Parliament separately. (Exhibit 19.5 presents a listing of some of the major costs to the government associated with the decision to transfer.)

Exhibit 19.5

Transfer Activities: Schedule of Costs

Departmental Activities	
Implementation activities	\$ 5.9 million
Negotiation activities	16.0 million
Corporate transition activities	3.6 million
Safety team activities	0.2 million
Sub-Total¹	\$ 25.7 million
Other costs of transfer:	
Additional Severance	31.5 million
Additional Pension ²	274.7 million
Capital Assets	43.5 million
Total³	\$375.4 million

Notes:

¹Transport Canada estimates the total at approximately \$25 million.

²The government estimates the cost of transferring pensions to NAV CANADA to be \$274.7 million. However, in the future this cost may be partially offset by approximately \$130 million due to the effects of favourable interest rates.

³These costs are unaudited and do not include the costs incurred by other organizations involved in the transaction such as Justice, Treasury Board Secretariat and Finance; or costs of setting up Transport Canada's regulatory organization; or environmental remediation costs. As a result, we have no assurance that the total does not contain a material error, or that it is complete.

19.68 Where major divestitures of government operations are involved, the government should prepare a report for Parliament that sets out the results of the divestiture. This document should include a description

of the transaction, an assessment of how the transaction as concluded is expected to meet the government's objectives for entering into it, and a summary report on the costs and proceeds of the transaction.

Severance and pension costs

19.69 In the spring of 1996, the air navigation system employees' pension liabilities to be transferred with them to NAV CANADA were estimated to total up to \$1.4 billion. Later estimates reduced this amount to \$1.3 billion. Severance payments were estimated at up to \$112 million.

19.70 Severance costs. Air navigation system employees transferring to NAV CANADA were paid an additional amount in severance because their employment with the government had been terminated (the entitlement rate for employees whose service is terminated is higher than for those who leave of their own volition). These amounts represent an additional cost of transferring the air navigation system and are estimated by the government to total at least \$31.5 million of the estimated total of \$112 million.

19.71 Pension costs. Under the agreement to transfer, employees had the option of transferring their pension to NAV CANADA or leaving it under the Public Service Superannuation Account. The government negotiated an amount to transfer to NAV CANADA for pensions that was significantly higher than the actuarial liability for these employees had there been no transfer. The amount to be transferred for each individual is the greater of either the actuarial liability on a negotiated set of assumptions or the result of a contribution test of twice the individual's accumulated contributions, with interest. The negotiated actuarial basis results in a larger actuarial liability than the public accounts assumptions, and the contribution test further increases the transfer amounts. Based on the information for the employees who actually transferred, we and the government estimate that the total liability could be up to \$1.3 billion (assuming all of the employees elect to transfer, as approximately 90 percent will). Of that amount, we estimate that up to \$275 million represents a cost attributable to the transfer, based on the combined effects on the liability of the negotiated assumptions and the contribution test. While this outcome is not unusual in pension transfer arrangements, in our view this amount represents a cost that should have been disclosed to the government as a separate cost directly related to the transfer. The government now advises us that because of favourable market interest rates, this cost will be partially offset by an amount that it currently estimates at about \$130 million.

Other Key Elements of the Transfer

Controls over the transition period

19.72 Although Transport Canada was under some pressure to complete the transfer quickly, it introduced some key controls that are worth noting as significant lessons to apply in future transfers. For example, detailed closing plans were prepared and communicated to ensure that key financial controls were implemented to protect the public purse after the transfer. The financial closing plan included a list of procedures such as the cancellation of credit cards and phone cards, and a series of procedures subsequent to the transfer to ensure that the Department would recover any expenditures it had incurred on NAV CANADA's behalf. Other procedures were put in place to ensure that assets identified in the agreement were transferred. Furthermore, the Department provided for these transition procedures to be managed by employees who had been identified to remain with the Department, to ensure that the government's interest was being taken into account.

Contingent liabilities

19.73 The government is in the process of completing its environmental assessment of the condition of the lands transferred to NAV CANADA. The potential environmental liabilities are estimated by Transport Canada at between \$5 million and \$20 million.

Contracts for Financial Services

19.74 In the course of our audit of the valuation of the air navigation system, certain concerns came to our attention about the contracting practices used by the Department in the acquisition of financial advisory services. These concerns represent matters that we believe ought to be brought to the attention of Parliament.

The initial contract for financial advisory services

19.75 Following the government's announcement of its intent to study the potential commercialization of the civil air navigation system, Transport Canada decided to contract for financial advisory services. The financial advisor was to challenge the assumptions for building the financial model of the commercialized entity. It was also to focus detailed study on three options for commercialization: a not-for-profit company, a mixed enterprise and a Crown corporation.

19.76 The Department called for bids on this work and a contract for \$165,000 was awarded. The contract covered the period from July to September 1994. It was subsequently amended on two occasions to extend the work period to March 1995 and to increase the amount payable to \$560,000.

The principal contract for financial advisory services

19.77 Early in 1995, Transport Canada decided that, as the next step in the commercialization of the air navigation services, it would require a financial advisor to assist its negotiating team. The advisor was intended to provide comprehensive financial advice leading up to a transaction, and to perform additional responsibilities in regard to financing the sale.

19.78 Initially, a sole-source oral contract was offered to the winner of the earlier contract. This appointment was confirmed by the contractor in a letter to the Department dated 25 May 1995. The written contract governing the provision of financial advisory services was not signed until after 12 April 1996, almost a year later. Much of the delay in signing the contract can be attributed to a request by the contractor for a revision of the indemnification clause. Ultimately, the contract was signed without the inclusion of the clause.

19.79 On 1 June 1995, the Department prepared a proposal for "Ratification of Contract" and submitted it to Treasury Board. The proposal was ratified on 15 June 1995. Ratification is normally required for contracts let without the required authority from the Treasury Board, as a result of either an administrative error or a pressing emergency.

19.80 In the proposal, the Department asked for retroactive approval of a non-competitive contract based on a transaction fee of 0.4 percent of the final price, not to exceed \$4.6 million, and payable in arrears from 1 May 1995. It put forward several points in support of its request.

19.81 **The need for sole sourcing.** The Department stated that in July 1994, a competitively tendered contract valued at \$560,000 had been awarded to the financial advisor for advice in connection with the commercialization of the air navigation system. In fact, the competitive contract had been awarded for \$165,000 and was later amended to \$560,000.

19.82 The Department pointed out that it was committed to having the terms of the transfer arranged by the fall of 1995, which meant that in its view there was not enough time to call for competitive bids and potentially allow a new firm to familiarize itself with all the complex issues involved. Hence, it concluded that the firm it proposed was the only one ready and able to act as the financial advisor during the time-sensitive negotiations expected with the new entity.

19.83 Transport Canada had known by February 1995 that a financial advisor would be required. We do not have any indication that a competitive process could not have been completed in the time available, or why it was necessary to enter into this contract without first having received the appropriate authorization.

19.84 According to section 6 of the Government Contract Regulations, there are only four exceptions that permit the contracting authority to set aside the requirements to solicit a bid. The information provided by the Department does not adequately explain its reasons for sole sourcing. We are concerned that the practice of sole sourcing based on a contractor having won an earlier, much smaller contract, which was let competitively, circumvents the competitive bidding requirements and is unfair to other firms.

19.85 The basis of payment. In support of its intent to reimburse the advisor using a transaction fee, the Department stated that according to advice received from the Department of Finance, a reasonable transaction fee rate would be between 0.4 percent and 0.7 percent of the negotiated price and that this rate is standard in the industry. Transport Canada has no record of advice received from the Department of Finance on this matter.

19.86 When initial discussions were being conducted with the financial advisor about the second contract, it was contemplated that in addition to providing service of an advisory nature, the advisor might be involved on behalf of the government in arranging (underwriting) debt financing for the new entity. A transaction fee would be usual for underwriting. However, by June 1995 when the request for ratification was sent to Treasury Board, the requirement for underwriting duties had been removed from the draft terms of engagement and no such requirement is to be found in the written contract that was signed. The duties specified in the statement of work, and ultimately set out in the contract, would not normally be paid for on the basis of a transaction fee.

19.87 Payment before written contract. By 22 September 1995, the contract had yet to be signed, due to disagreements about the appropriateness of indemnification clauses as proposed. However, the Department made a decision to pay for services rendered on the basis of an oral contract, and over \$1.4 million was paid to the contractor before the contract was actually signed.

19.88 Amendment. On 20 March 1996, the Department submitted to Treasury Board a request for approval to amend the price ceiling in the still-unsigned contract, from \$4.6 million to \$6.9 million. It stated that this amendment was required to reflect the significant increase in value achieved by the government for the sale of NAV CANADA and for additional services required. The request does not specifically note a decision made nearly a year earlier that services to arrange financing on behalf of the government would not be required of the advisor under this contract, or that a contract had not yet been signed.

19.89 Lack of deliverables. We did not find well-defined deliverables in this contract. Although Transport Canada has advised us that it received the financial advice it needed when it was needed, it is unable to demonstrate whether value for money was received from this \$6.9 million contract because it did not keep track of the time its financial advisors spent on the project or request that the advisors provide this information, to which it was entitled.

19.90 Questions about independence of advice. In May 1996, the Department gave permission to its financial advisor to participate in financing activities for the purchaser. The advisor's contract with the Department did not expire until the fall of 1996, at which time a final payment was made. According to NAV CANADA's prospectus, the financial advisor participated in the underwriting syndicate for NAV CANADA and shared in the transaction fee charged to NAV CANADA, which is the usual form of reimbursement for such activities. According to the financial advisor, its involvement with NAV CANADA did not begin until after the transfer had taken place, and its role was limited to the distribution of the securities.

19.91 We did not audit the financial advisor and we offer no opinion on its actions. Where our work touched on that of the financial advisor, we were concerned only with the appropriateness of the government's actions.

19.92 It would be reasonable to expect the government to require that its advisor on price, due diligence and negotiation strategy remain independent from the purchaser all the way through the negotiations, until the commercial closing of the deal and the physical transfer of the air navigation system. Accordingly, the Department should not have released its financial advisor from its exclusive duty to it until the transfer had been fully completed.

19.93 More generally, in many divestitures of government operations it is likely that, as in this case, in practical terms the relationship between the vendor and purchaser will be at less than full arm's-length. Government operations are often sufficiently specific that both management and labour will be a part of the divestiture. In these circumstances, in our view, it is vital that the independence of the financial advisor be fully maintained to ensure that the interests of the Crown are protected.

19.94 **In future transfers, to protect the interests of the Crown, the government should ensure that the independence of the financial advisor is appropriately maintained in light of the nature of the transaction and the scope of the advisor's role in it.**

The contract for a second financial advisor

19.95 On 19 June 1995 the Department sent out requests for proposals, seeking an American investment banking firm to act as an advisor to it on sale matters such as those related to the United States and international capital markets.

19.96 There were three compliant bidders. Their proposals were evaluated and the contract was awarded. The time taken to process this competitive contract, from the date of issue of the request for proposals to the selection of an advisor, was only 42 days.

19.97 The initial contract with the American advisor was for US \$375,000 and covered the period 1 August 1995 to 31 October 1995. There were a number of amendments to the contract, increasing the value from US \$375,000 to US \$1,050,000 and extending the time for completion to 1 April 1996. This financial advisor was contractually prohibited from participating in the financing activities of NAV CANADA.

19.98 As was the case with the other contract for financial advice, the deliverables were unclear and the Department's records provide no clear link, other than elapsed time, between the work actually done and the amounts paid. Further, the Department has not provided any evidence of the services paid for under this contract for the period of January through March 1996.

Department's comments: Transport Canada's comments on this section can be found at the end of this chapter beginning at page 19-28.

The Regulation of Safety

19.99 The transfer of the air navigation system to a private corporation meant that the Department was no longer responsible for delivering these services. However, in the process it has become responsible for ensuring that NAV CANADA, the new deliverer, does so safely and in compliance with the *Aeronautics Act* and the Canadian Aviation Regulations, and in accordance with Canada's international obligations. When it becomes aware of a safety deficiency, the Department must attend to it expeditiously. To achieve these goals, the Minister announced, "Transport Canada has established safety regulations and standards that will apply to the new corporation and will monitor its operations to ensure compliance — just as the department now does in the case of commercial air carriers — thus ensuring the continued high level of safety Canadians have come to expect."

19.100 Meeting this commitment represented a formidable challenge for the Department. It was faced with developing and instituting a regulatory regime where previously there had been internal management oversight. This had to be done in a period of about 18 months, without skirting any of the requirements for consultation and notice. This did not mean, however, that the Department was starting from zero. Like all parts of the aviation industry, the delivery of air navigation services is highly structured and disciplined; it is bound by a web of internal procedures and international standards that specify both what is to be done and (often in considerable detail) how to do it. These instruments, particularly the very comprehensive body of International Civil Aviation Organization (ICAO) standards to which Canada subscribes, formed a solid foundation on which to build a regulatory regime.

Transport Canada uses performance-based regulation

19.101 In regulating NAV CANADA, the Department decided to adopt a performance-based approach. In this type of regime, the regulator defines very clearly the results to be achieved (or avoided), and permits the regulated party to decide how it will deliver those results while providing the regulator with the comprehensive data it needs for timely assessment of performance.

19.102 Advantages and risks. This approach has the advantage of being less intrusive and less costly to administer than a prescriptive system. It is assumed that in providing performance data and in assessing its own performance, the regulated party will bear most of the cost of regulation, and the regulator will be able to gain assurance of performance through review of the performance reports and a highly selective program of audits and inspections. However, such an approach is not without its risks. The Department's Safety Review Team noted that setting up the necessary information and performance measurement systems has been an obstacle to success in other attempts at this approach. The team particularly noted the difficulties in doing this in the reform of the rail safety regime, identified by the Railway Safety Act Review Committee in its report.

19.103 The Department has stated that the decision to adopt a performance-based approach to regulation was based on its overall approach to regulation and regulatory reform, which emphasizes the use of performance-based regulations where possible. The decision was made without benefit of an adequate analysis of the appropriateness, including the risks and benefits, of using performance-based regulation for the delivery of air navigation services by a private corporation. Developing a revised regulatory regime, starting from a well-established set of regulations and regulatory procedures in a relatively stable set of relationships, is a task very different from setting up a new regime for a new organization with new senior management. However, the risk was mitigated by the fact that the new regulations were fully reviewed by the Canadian Aviation Regulatory Advisory Council, a group made up of representatives from all areas of the aviation industry.

19.104 The new regulatory program for the civil air navigation system was not developed on the basis of a comprehensive analysis of the risks inherent in it. Although work was done to identify the relative seriousness of the principal hazards in the system, no documented risk analysis was conducted.

19.105 Because it assessed as low the safety risks inherent in NAV CANADA's early operation of the system, the Department's strategy was to start with the minimum number of components for a performance-based program. This decision was based on three assumptions:

- that the air navigation system, as provided by the Department at the time of transfer, had achieved an acceptable level of safety;
- that the operational environment would remain relatively stable after the transfer; and
- that the transfer would be "seamless."

19.106 Our work looked at two issues. First, effective performance-based regulation requires a number of components, which have been identified in the literature and in internal departmental reports. We assessed the extent to which those components are in place. Second, any regulatory regime requires that the regulator undertake a number of tasks in order to have assurance about the level of regulatory compliance. We looked at the Department's activity in this area; that is, at the procedures it had in place to obtain assurance that air navigation services were being delivered safely.

The System Safety Review

19.107 One of the key activities carried out by the Department in preparing for its role of safety regulator was the System Safety Review. This was an ongoing process that began in June 1995 and ended with the final report in July 1996; four interim reports were issued. The purpose of the review was to provide the Department with an ongoing assessment of the risks associated with the transition of the air navigation system from a government operation to a private enterprise.

19.108 The System Safety Review report identified several basic requirements for a performance-based regulatory regime:

- identification of regulatory goals;
- general reliance on standards of quality and performance measurement;
- determination of the most effective means of mitigating and monitoring air navigation system-related risks; and
- development of extensive feedback mechanisms to sample, analyze, and evaluate the effectiveness of the risk mitigation.

19.109 These requirements are very close to those we identified in setting our criteria for this part of our audit. We expected that in setting up such a regime the Department would develop:

- clear and comprehensive performance objectives or goals for each of the areas subject to regulation;
- a formal risk analysis leading to the identification of the key performance goals for which data are to be gathered to monitor performance;
- the specifications of the measurement procedures and data to be used to monitor performance;
- procedures to ensure timely and unimpeded access to all necessary data;
- assessment of the data quality; and
- procedures to carry out independent verification of the data.

19.110 We discuss each of these below.

Performance goals for air traffic control

19.111 We found that the Department had established in the regulations the key performance criteria for air traffic control services, in the form of the Canadian Domestic Air Traffic Control Separation Standards. The critical performance goal for this area is the avoidance, through appropriate air traffic control, of losses of separation (distance) between aircraft. In other areas, such as the provision of navigation aids, the relevant ICAO standards have been incorporated into the regulations by reference; however, the ICAO standards are extensive, detailed and largely prescriptive. One area, automated systems, does not appear to be subject to any regulation, nor are there any current ICAO standards that apply, although Canadian air traffic control depends on such systems to a significant degree. In the interim, the Department is working on these issues with NAV CANADA to develop appropriate standards for automated systems performance. Once ICAO has developed standards in this area, they will apply to NAV CANADA.

Need for risk analysis

19.112 In a performance-based system that regulates an area as large and complex as the air navigation system, it is not practical to monitor everything. Risk analysis assists management in identifying the areas that need the most attention, and encourages the most cost-effective allocation of resources.

19.113 The need for risk analysis was identified relatively early in the System Safety Review process. The System Safety Review Team identified and catalogued the risks in the existing air navigation system and those inherent in the new regulatory regime, but it realized that its work was not a substitute for the type of systematic and quantitative analysis that was and is required. Since the transfer, the Department has settled on the methodology it will use for risk analysis and has identified the need for staff training. However, it will be some time in the future before the necessary analysis using the new methodology can be undertaken.

Reporting on performance of the air navigation system

19.114 Once the performance goals to be measured and the indicators to be used to measure them have been defined, the sources of the data used to create the indicators must be identified. For the air navigation system, the principal source of data is an incident-reporting system operated by Transport Canada, called CADORS (Civil Aviation Daily Occurrence Reporting System). Until the transfer, CADORS was an internal departmental management system designed to provide for quick reporting of a wide variety of aviation occurrences so management could identify problems and act quickly when necessary.

19.115 The new regulations have imposed on NAV CANADA the requirement to produce reports that conform with the requirements of the CADORS Manual. The CADORS has the capability to provide relatively complete information on losses of separation — the avoidance of which is the principle objective of air traffic control services. However, while it can and does provide information on other aspects of the air navigation system, such as reporting on identified beacon failures, other sources of information on many NAV CANADA services will have to be identified.

19.116 The requirement that NAV CANADA report in accordance with the CADORS manual should, subject to NAV CANADA's compliance, provide for the timely reporting of key data.

19.117 One of the problems identified in the System Safety Review was whether all incidents that were reportable under CADORS would be reported. This had been a problem and was anticipated to continue after the transfer. Transport Canada needs to work out a means whereby it can gain assurance that the CADORS reports it receives from NAV CANADA are complete. Since the transfer, there have been some problems in this area and the Department has informed us that it has taken steps to gain greater assurance. It compares the reports it receives from NAV CANADA with data from the mandatory incident-reporting system operated by the Transportation Safety

Board. We have requested documentation of this process, but the process appears to be relatively informal and no documentation has been provided. While the threshold of seriousness in the Safety Board's system is higher than in CADORS, a proper reconciliation would provide some assurance on the consistency of reporting between the two systems, and at a relatively low cost.

19.118 The Department has indicated to us that it is concerned about the problems of having a number of different systems measuring various aspects of aviation safety, using different definitions and sensitivities. It is considering developing a single system to capture the necessary performance information on a consistent basis. In view of the Department's commitment to increase the use of performance-based regulation, the development of reliable and economical sources of data is important.

Independent verification of performance data

19.119 One of the obligations of the regulator, particularly in a performance-based regulatory regime, is to perform independent tests from time to time to derive the necessary assurance that the information on which it is relying is accurate and complete. In the case of the air navigation system, such verification is made possible by the requirement that recordings of both voice and operational information be made and retained by NAV CANADA. Considerable operational data can also be obtained from flight records and tapes.

19.120 In a new regulatory environment, one would normally expect the level of audit activity to be quite high, declining over time as problems were resolved and assurance of reliability achieved. However, by the end of our audit fieldwork the Department had neither planned nor conducted any audits to verify the quality of the data supplied by NAV CANADA.

Audit and inspections of safety

19.121 One of the key elements in the safety regulatory regime is the requirement that NAV CANADA have a safety management program by which it monitors, inspects and reviews its own operations. Transport Canada believes that once this program is fully operational, it will be able to derive much of the assurance it needs about NAV CANADA's compliance with the necessary procedures by receiving and reviewing the products of that safety program. It should be noted that while NAV CANADA is required by the regulations to develop such a program, the program will not be required to meet with Transport Canada's approval. Nor, it appears, would the absence of that approval bar NAV CANADA from operating the air navigation system.

19.122 Once NAV CANADA's safety program has been completed and put fully into operation, the Department will still need to supplement its receipt and review of NAV CANADA's reports with direct audits and inspections of its own. As noted in our discussion of data verification, we would expect the level of audit to be relatively high until a clear pattern of reliance has been established. In particular, we would expect the effort to be particularly intensive during the period when management's controls and procedures are still being designed and put in place. By the completion of our audit work, however, because it assessed the risks as low, the Department had only limited audit plans to conduct Site Manual validations and had not yet done any safety audits of NAV CANADA.

Safe delivery of air navigation services

19.123 When the government agreed to the transfer of the air navigation system, one of the conditions it established was that the necessary safety regulations and the Transport Canada resources to apply and enforce those regulations be in place prior to the transfer. The Department had the current regulations in place prior to the transfer date, and it had staffed some, but not all, of the positions in the new directorate that is responsible for regulating NAV CANADA. In particular, the Department has stated that all key personnel were in place with adequate resources. However, as we have noted, Transport Canada has some distance to go before it has in place a fully functioning regulatory regime for NAV CANADA. The legal and regulatory foundations have been established and

the Department has very recently approved its Policy Framework for the Safety Oversight of Canada's Air Navigation System. Nonetheless, there are important matters of risk, data, and audit and inspection that must be resolved before the regime can be said to be fully operating. Based on the System Safety Review and a consultant's follow-up report for the Department after the transfer, the Department is fully aware of the issues that need to be resolved and is in the process of drafting action plans and taking steps to deal with them. According to the Department's plans, it will take well into the next year to resolve some of the outstanding issues related to risk analysis and performance measurement.

19.124 In discussions with departmental officials we have been informed that there is nothing untoward in this state of affairs; in their view, the risks inherent in the situation are very low. Indeed, the Department has written to us to state that in its view, as at the date of transfer and since then, the necessary safety regulations and Transport Canada resources for the application and enforcement of those regulations have been in place and functioning in all material respects. While the Department has not fully implemented its safety oversight program, and does not have assurance of NAV CANADA's compliance with the safety requirements of the Canadian Aviation Regulations, it points to a number of factors that give it some comfort that it would be aware of any problems that existed. These factors include the view that prior to transfer the system was safe and that it will continue to be operated by NAV CANADA in the same way, including the continuation of all of the system safety oversight activities formerly carried out by Transport Canada; its strong belief that NAV CANADA's management has no incentive to operate in other than a safe manner; the data and information that it currently receives from NAV CANADA, including personal contacts with key NAV CANADA personnel; and, at senior levels in the Department, ongoing contacts with NAV CANADA's clients.

19.125 Comfort, however, is not assurance. Assurance is the result of a planned process of analysis and investigation. Until Transport Canada has made significant further progress in implementing the key elements of its performance-based regulatory regime, it will not be in a position to have full assurance concerning NAV CANADA's operational compliance with the requirements of the Canadian Aviation Regulations and ICAO standards. At the end of our audit, more than half a year had passed since the transfer and no audits or inspections of NAV CANADA's operations had been conducted by Transport Canada.

Transport Canada's comments:

Regulation of Safety

Transport Canada is confident that the new air navigation system provider, NAV CANADA, is committed to highly safe operations and indeed the Canadian Aviation System remains among the safest in the world. This commitment to a high standard of safety is ensured by:

- 1. the government's regulatory powers under the Aeronautics Act;*
- 2. the authority of the Minister under the Canadian Aviation Regulations to issue an order to NAV CANADA to maintain or increase the level of service in the interests of safety; and*
- 3. the requirement to notify Transport Canada of any occurrences, coupled with the Department's powers to inspect and audit.*

The government has authority under the Aeronautics Act over all aspects of aviation including the safety oversight of air navigation system service providers. Part VIII of the Canadian Aviation Regulations (CARs) applies specifically to the air navigation system. The regulations provide for standards to be achieved by NAV CANADA, and the Aeronautics Act provides the authority for audit and inspection of services and facilities. Licensing and training standards for air traffic control are also specified in Part IV of CARs. NAV CANADA must also notify the Minister of the termination or reduction in the level of service and the Minister has the authority to request that the

service be maintained or increased in the interest of safety. The Department is vigilant in overseeing operations to ensure that Canada's exemplary aviation safety record is maintained in the new, innovative operating environment.

The Auditor General recognizes that prior to the transfer of the air navigation system to NAV CANADA, Transport Canada had established the legal and regulatory foundation for the regulation of NAV CANADA. Transport Canada had also established a multi-disciplinary team to assess the scope of the safety oversight program, developed a new branch with inspection and audit authority, and completed a comprehensive System Safety study.

Further work has been completed since the transfer, such as the completion of a Regulatory Framework, which includes the program for inspecting and auditing facilities and investigating safety issues and incidents.

It had been more than 50 years from the inception of the air navigation system until its sale to NAV CANADA, at which time the personnel and operating infrastructure were transferred in total. As a result, at the time of the transfer, it was the Department's assessment that the air navigation system had achieved an acceptable level of safety and that the new corporation would assume management of the air navigation system in a responsible, professional and safe manner, given that there was essentially no change in operational staff and that an effective safety program had been established by NAV CANADA.

The studies referred to in the Auditor General's Report were initiated by the Department as a self-assessment of the air navigation system's regulatory safety program and the status of implementation. Both an internal study and a consultant study have been used to reconfirm and refine elements of the program. The self-assessment studies initiated by the Department reflect the philosophy of continuous improvement needed in a highly technical and complex national air transportation system.

Value and Process

The Department is of the view that the price agreed upon for the air navigation system represented the best deal available in the circumstances at the time of the transfer.

Both the purchase price and the choice of a one-phase transfer were appropriate and completely justifiable, given:

- the policy decision to pursue exclusively the not-for-profit corporation model with user group involvement;*
- the economic climate and risks assumed by the purchaser;*
- the need to move quickly to capitalize on industry and employee consensus; and*
- the pressing need for a new management model to meet current technological challenges.*

One of the government's key objectives was to transfer the air navigation system to a not-for-profit corporation with a suitable balance of stakeholder interests and an acceptable framework for accountability, governance and safety. Considerable time and effort were invested during 1994-95 in working with an Advisory Committee made up of a wide diversity of stakeholders to arrive at such a balance of interests.

Clearly, it was an immense step to move from a departmental program into a private sector corporation. However, a two-phase approach would have delayed implementation of organizational improvements and led to continuing technological and operational delays for air navigation system users. It was also important to seize the window of opportunity presented by the consensus that had been reached in the aviation community and with ANS employees and their bargaining agents as to the direction to be taken.

An extensive study phase preceded the decision to transfer the system, during which various criteria and assumptions were developed and a number of financial models and other equally important aspects of the proposed transfer were examined. Following this study phase, a set of principles to guide the negotiations was approved by Cabinet.

The monetary value was important for the government. However it was not the sole objective. If it had been, the transfer would not have taken place the way it did. This context is ignored in the Auditor General's review of the transaction. It might have been easier to address the value question and other matters through a two-phase process. However, given the opportunity to capitalize on the acceptance of alternative service delivery concepts, the "user pay-user say" willingness exhibited by the aviation industry and the need to move quickly, the government decided to commercialize the air navigation system directly from a departmental program.

There is also an historical context to the negotiations that is ignored in the Auditor General's report. This opportunity was being pursued in a period of considerable economic uncertainty and risks that had to be managed, such as:

- interest rates;*
- the deficit;*
- credit ratings;*
- future trends in aviation traffic;*
- the potential for revenue fluctuations;*
- uncertain operating and technology system modernization costs;*
- the challenges of introducing efficiencies to the system while at the same time retaining good relations with a unionized workforce.*

All of these factors affected the nature of the transfer of the air navigation system to an entity that had to exhibit long-term viability to lenders. There were legitimate concerns about the ability of a new entity to raise very large amounts of funds at an acceptable cost. It was concluded that these factors contributed to a value that could be represented not only by cash but also by the acceptance by NAV CANADA of these obligations and risks.

The opportunity was seized and the price was negotiated within this context.

With respect to the determination of monetary value, depending on the model and assumptions used, a wide range of values for the air navigation system was generated, varying from approximately \$1.1 billion to \$2.6 billion depending on the assumptions. Given the decision to use the not-for-profit model, and that negotiations took place between a willing and knowledgeable purchaser and seller, it is the Department's opinion that the \$1.5 billion cash proceeds represented the best deal available given all of the circumstances at that time.

It should be recognized that the purchase price or value ultimately has to be recovered from users of the air navigation system. The not-for-profit entity ensures that users are not burdened with the profit-maximizing objective of a for-profit entity that would pass on this additional cost to users.

Transport Canada had to address many of the information requirements to complete this transaction on an ongoing basis. Information to the Treasury Board and other decision makers was disclosed as the data became available for reconciliation and consolidation.

It is true that the Department was unable to identify all of the ultimate points around the transaction until certain building blocks and timing issues were completed. This situation made accurate determination of certain costs impossible until much later, but at no time were decision makers misinformed as to the magnitude and implications of the contemplated transaction.

Contracting Practices

Transport Canada had a short period of time to achieve the commercialization of the air navigation system. Following the Budget of February 27, 1995, the Minister of Finance announced the government's intention to proceed with the commercialization of the air navigation system. The Department was to achieve this result as early as possible in fiscal year 1996-97.

Given the relatively short timeframe to achieve this result, the Department elected to build upon the expertise and familiarity of a financial advisor who had previously assisted in developing appropriate models for the commercialization of the air navigation system. The advisor would be retained to provide a variety of financial services to the Department to implement the "not-for-profit" model. The time required to potentially bring another financial advisor "up to speed" through a competitive contracting process would have severely impeded the Department's ability to meet the expected timeframe for implementing the commercialization of the air navigation system. This exact rationale was provided by the Department in its submission to the Treasury Board to ratify a non-competitive contract with a financial advisor.

The execution of a written contract between the Department and the financial advisor did take several months to complete, as the Department and the financial advisor could not come to a successful resolution on a common understanding of the term "indemnification" in the context of this particular contract. However, all other conditions of the proposed written contract were agreed to by the parties at the very early stages of the contract engagement.

Paragraph 19.86 of the Auditor General's Report makes reference to underwriting duties of the financial advisor being "removed from the draft terms of engagement and no such requirement is found in the written contract that was signed." The Department erred by this omission, as it had been an integral part of the negotiation and contingency planning process with the financial advisor and was included in the agreement with the financial advisor.

Treasury Board Secretariat's comments:

Severance and Pension

On severance, the government's decision was that it would honour its contractual obligations and respect the collective agreements with its unions, i.e. to pay severance at the lay-off rate. This decision was taken with full knowledge of the associated higher costs.

On pensions, the overall potential liability transferable for pensions, estimated at up to \$1.4 billion, was fully disclosed to the decision makers, as well as the proposed terms of the agreement. The negotiated actuarial assumptions recognized that NAV CANADA would be investing the transferred funds at prevailing market rates while the government returns were based on investments made over the past 20 years.

In our view, the additional costs in the chapter are overstated and the final amount is expected to be some \$100 million to \$120 million in excess of the actuarial liability. This amount will reduce the growth in the actuarial surplus in the Public Service Superannuation Account but does not increase the government's expenditures related to pensions.

Contracting

It is the view of the Secretariat that the contract submissions from Transport Canada, as approved by the Treasury Board, were supportable and met the requirements of the Government Contracts Regulations and, apart from the retroactivity involved, conformed to the Treasury Board Policy on Contracting.

About the Audit

Scope

Our audit focussed on the key elements of Transport Canada's implementation of the government's decision to transfer the civil air navigation system. We examined the definition and valuation of the entity to be sold, the controls in place to safeguard government assets during the transition, the compilation and disclosure of the costs to the government of the transfer, the contracting for financial advice and the procedures that Transport Canada had put in place to obtain assurance that NAV CANADA was operating the system safely. We did not audit the safety of the air navigation system and provide no opinion on it.

It should be noted that prior to the decision to transfer, Transport Canada considered several options for the commercialization of its air navigation system. Options such as the establishment of a Crown corporation or a mixed enterprise or the transfer to a not-for-profit private corporation were studied in detail. We have not audited the government's decision to transfer the air navigation system or its decision to transfer it to a not-for-profit entity.

Several other areas were excluded from the audit: Transport Canada's negotiation strategy; review of Transport Canada's overhead, direction and administration costs after the transfer; the impact of the timetable on the quality of the agreement to transfer; the roles and responsibility of Transport Canada after transfer, other than safety; NAV CANADA's effectiveness in meeting the objectives set by the Government of Canada for transferring the air navigation system; minimum levels of service; air navigation system guarantees; and the introduction of NAV CANADA's charges to replace the Air Transportation Tax.

We did not audit NAV CANADA and express no opinion on its actions.

Objectives

Our audit objectives were to assess whether:

- Transport Canada protected the taxpayers' interests by following the government's direction to receive fair market value from the sale of the air navigation system, and exercised due regard to economy in the valuation of the entity being sold;
- there was full disclosure by Transport Canada to decision makers of information on the value of the air navigation system;
- Transport Canada disclosed to Parliament the full cost of commercializing the air navigation system;
- Transport Canada put in place the necessary control procedures to safeguard assets and control liabilities during the transition period;

- Transport Canada followed the contracting rules in contracting for financial services;
- Transport Canada received value for the price paid for advisory services;
- Transport Canada has put in place the components necessary to support its performance-based approach to the safety regulation of air navigation services; and
- Transport Canada has carried out the various tasks — risk analyses, data analyses, audits and inspections — necessary to provide it with assurance of NAV CANADA's compliance with the laws and regulations governing the operation of the air navigation system.

Audit Team

Régent Chouinard
Charles Gay
Sonja Heikkila
Michelle Lavallée
Rosemary Marenger
Alnoor Nathoo
Nicole Bertrand-Pétrin
Marial Stirling
Cyril Lee-Shanok
Sami Sourani
Jaak Vanker
Judy Wong

For information, please contact Hugh McRoberts, the responsible auditor.

Chapter 20

Public Works and Government Services Canada

Privatization of the Canada Communication Group

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Public Works and Government Services Canada

Privatization of the Canada Communication Group

Assistant Auditor General: Shahid Minto

Responsible Auditor: Alain Boucher

Main Points

20.1 The government made the decision to privatize the Canada Communication Group (CCG) and approved the sale process in April 1996.

20.2 The government's privatization objectives were to obtain best value for the sale of CCG, with minimum risk and liability for the government, and to minimize the impact on the printing industry while securing job continuity in the private sector for as many of its employees as possible. The government did not offer any guarantee of future business. However, to sell under the best conditions possible, it offered to prospective purchasers a business advantage, for a period of five years, in the form of privileged access to all government departments and agencies.

20.3 CCG was sold through a competitive sale process. The invitation to submit bids was made through the Open Bidding System. We found that the process was indeed open and attracted a significant number of bidders from the printing industry. The evaluation of offers received was conducted in accordance with the stated process and resulted in a proper evaluation of the bids. We therefore concluded that the offer submitted by the successful bidder, St. Joseph Corporation, represented the best value that could be obtained at that time under the conditions of sale specified by the government.

20.4 We found that there was satisfactory control over the transfer of assets and liabilities to the purchaser and that adequate revenue and expense cut-off procedures were used at the closing of the transaction.

20.5 CCG estimated the net cost for the divestiture of the organization at \$45.3 million. However, certain costs to be absorbed by other federal government entities as a result of the privatization were not included in this amount. Those costs included the waiving of about \$20 million to \$25 million of pension penalty costs for those who benefited from early retirement, and costs related to pension protection. The inclusion of the pension penalty costs alone would have brought the net cost of privatization to between \$65 million and \$70 million. In addition, the pension penalty costs were not included in CCG's analyses of the various future options for the organization. The inclusion of this cost element could have had an impact on the results of the cost/benefit analyses conducted.

20.6 We tested a sample of cases related to the Work Force Adjustment program established for CCG and found that they all complied with the conditions of the program. As well, we determined that the CCG program was comparable with the programs of departments and agencies subject to the Treasury Board Work Force Adjustment Directive.

20.7 We consider that the privatization process was well managed within the parameters set by the government; however, it is too early to predict whether this privatization will be a success in the longer term. Fairness to prospective purchasers and employees and jobs for employees were important criteria for the government, but resulted in costs (such as Work Force Adjustment costs) exceeding those that would have been incurred in a private sector transaction.

Introduction

20.8 In its February 1995 Budget, the government announced its intention to examine the prospects for the divestiture of the Canada Communication Group (CCG). The following July, the Minister of Public Works and Government Services Canada (PWGSC) established a specialist committee, comprising public and private sector experts in privatization, finance and human resources, to make recommendations on which components of CCG should be privatized, the public policy implications, employee considerations and the process to be followed. CCG hired a financial advisor to establish a value for the CCG business lines and to identify strategies for its sale that recognized the costs of public policy issues.

20.9 The recommendations of the specialist committee and of the financial advisor formed the basis of the privatization plan that was approved by the government. In May 1996, the Treasury Board gave its approval and the Minister of PWGSC announced the decision to privatize the printing and warehousing/distribution operations of CCG. The objective, as stated by the Minister, was to get the government out of a business that could best be operated in the private sector.

20.10 A competitive sale process began in June 1996 and, on 12 December 1996, the Treasury Board approved the sale of CCG to the Canadian-owned St. Joseph Corporation of Toronto. The Agreement of Purchase and Sale was signed the following day and the actual transfer to the new owner took place on 7 March 1997.

Evolution of the Canada Communication Group

20.11 The Canada Communication Group changed from a directorate within the Supply Operations Sector of the then Department of Supply and Services to a special operating agency (SOA) in June 1990. It was one of the first five special operating agencies created by the government. It operated under a revolving fund with the statutory authority to use its revenues to cover its expenditures. Its financial statements were similar to those of a private sector enterprise. Exhibit 20.1 provides some key dates in the history of the government printing function.

Exhibit 20.1

Government Printer's Function - Key Dates

1869	The government appoints the Queen's Printer to supervise the printing of the Dominion's laws and its official newspaper, the Canada Gazette.
1886	The Queen's Printer also becomes the controller of stationary and assumed responsibilities for the printing requirements for Parliament. For the first time, all work was being done in a printing plant directly owned and operated by the government.
1969	The mandate is expanded to serve all of the federal government, not just Parliament and the Departments of Justice and Finance.
1970s	Many small printing facilities are combined with the Queen's Printer into the Communication Services Directorate of the then Department of Supplies and Services.
1990	The Communication Services Directorate becomes a special operating agency and is named the Canada Communication Group (CCG). Its printing services are mandatory for federal departments and agencies.
1992	CCG's services become optional to federal departments and agencies. CCG acquires the use of its own revolving fund, and starts to produce its own financial statements.

1993	CCG becomes a separate employer with complete accountability for its employees.
April 1994	Public Relations and Print Contracting Services function is transferred to PWGSC.
February 1995	The Budget reveals the government's intention to examine the divestiture of CCG.
May 1996	The plan to privatize CCG except some core functions such as the editing of the Canada Gazette is announced.
December 1996	An Agreement of Purchase and Sale is signed with St. Joseph Corporation.
March 1997	The Canada Communication Group is officially privatized.

Products and services

20.12 CCG provided printing, distribution and warehousing, publishing and information management services to government departments and agencies on a fee-for-service basis. Some additional services were funded by annual appropriation, including a public reference service. CCG was also responsible for certain mandatory services such as the publication of the Canada Gazette and the Statutes of Canada, and the administration of Crown Copyright.

The Decision to Privatize

20.13 Until 1992, CCG's services were mandatory, which meant that federal departments were obliged to use CCG for their printing and communication needs. In 1992, the government changed this policy in response to recommendations made by the Public Service 2000 Task Force and made optional as many common services as possible. Henceforth, most services offered by CCG were provided on an optional basis, which meant that individual department managers had the right to choose their suppliers of printing services or to do the work themselves. Only the publication of the Canada Gazette and the administration of Crown Copyright remained mandatory services of CCG.

20.14 This shift in the Treasury Board's common services policy had a major impact on all common services units using revolving funds. CCG was expected to operate in a revenue-dependent mode in a competitive environment. It had to demonstrate to customer departments that it could provide the best-value services.

20.15 CCG faced challenges from competitors in the private sector claiming that it had an unfair competitive advantage because of its dual role as a broker and a provider of printing and communication services. Although an external review conducted at the time found that no conflict of interest had actually arisen, the printing procurement services (broker) function was nevertheless transferred back to the parent department to remove any appearance of conflict of interest.

20.16 The loss of its mandatory status and the transfer of the broker function to PWGSC (which accounted for about \$150 million in sales alone) caused CCG's sales to decrease from about \$400 million annually in 1993 to about \$100 million in 1996. Exhibit 20.2 provides key financial results from 1993 to 1997.

Exhibit 20.2

(This exhibit is not available, see the Report)

20.17 In the summer of 1994, the Minister of PWGSC announced the establishment of an advisory committee composed of individuals from the public and private sectors to provide advice on the further direction of CCG. The committee tabled its report in December 1994 in which it recommended privatization of all functions of CCG that

could best be done in the private sector, and the creation of the specialist committee to plan the privatization initiative. Subsequently, the Government Program Review Task Force made a similar recommendation.

20.18 CCG examined various options and carried out cost/benefit analyses on each of them before the final decision to privatize was made by the government. The four main options analyzed were closing the organization, maintaining the status quo, downsizing CCG (competitive model) and privatizing with incentives. As a result of negotiations and decisions between February 1995 and December 1996, a Work Force Adjustment benefit program comparable with those for the rest of the public service was implemented for CCG. Analyses of all options included estimated Work Force Adjustment costs.

Functions privatized and those retained by the government

20.19 The functions that could best be done by the private sector were privatized. Some others were considered core functions of the government or not yet ready for privatization and were transferred back to the parent department or to other departments.

20.20 The remaining corporate services employees in the areas of human resources, finance, engineering and information technology who were not offered a job with St. Joseph Corporation or with the government will be declared surplus when their positions are no longer required.

20.21 Exhibit 20.3 gives the list of the business units that were privatized and those that were retained by the government.

Exhibit 20.3

List of the Business Units

Business Units Privatize(\$ millions)	Sales for 1995-96 31 March 1996	Staff on
Main Plant in Hull	29.6	238
Distribution Logistic Services	23.4	113
NCR Printing Centres Division	28.6	197
Atlantic Region Printing Centres	3.2	17
Ontario Region Printing Centres	5.2	30
Quebec Region Printing Centres	1.9	15
Pacific/West Region Printing Centres	5.8	37
Subtotal	97.7	647
Functions to be retained by Canada	12.7	80
<ul style="list-style-type: none"> • Editing and composition of the Canada Gazette • Crown Copyright administration • Depository Services Program • Reference Canada • Map printing 		

• Publishing		
Functions to be dissolve	NIL	122
• Corporate services		
TOTAL	110.4	849

Source: Office of the Auditor General

Government privatization objectives

20.22 In an address to the Canadian Printing Industries Association in May 1996, the Minister stated that the aims of the government were to obtain the best value for the sale of CCG, with minimum risk and liability for the government, and to minimize the impact on the printing industry while securing job continuity in the private sector for as many of its employees as possible. The Minister reiterated the position that the government was committed to competition, freedom of choice and fairness, and therefore would not offer the buyer of CCG any guarantee of business. Managers in individual departments would continue to choose the best-value supplier for printing services.

First privatization of a common services organization

20.23 The sale of CCG was the first privatization of an optional internal services unit in the Government of Canada and also the first unit that was not privatized as a legal entity. The government had no previous experience in this type of privatization. Earlier privatizations had involved mostly selling shares of Crown corporations such as Teleglobe Canada, Air Canada, Petro-Canada and Canadian National Railway. This time the government sold assets, rights and privileges.

20.24 It was also the first time that a special operating agency had been sold. In a study of SOAs by the Auditor General of Canada and by the Secretary of the Treasury Board in 1994, it was observed that the SOA initiative might best be seen as an alternative service delivery regime, and also as a transitional state that could eventually lead to more independent organizational forms within the government or in the private sector.

Focus of the Audit

20.25 Our audit objectives were to review:

- the openness and transparency of the privatization process;
- the value obtained and terms agreed with the purchaser;
- the control over the transfer of assets and liabilities to the new owner; and
- the costs of the privatization.

We also examined human resource considerations.

20.26 The decision to privatize CCG was made by the government in April 1996. We did not examine the merits of the decision.

20.27 We conducted this audit by taking into account the objectives and parameters set by the government. Our audit work focussed on the period beginning with the Treasury Board decision of 16 May 1996, which approved PWGSC's submission for the divestiture of CCG, up to the closing of the transaction on 7 March 1997.

20.28 The fieldwork of this audit was completed in June 1997. The government is providing financial and information technology services to the purchaser on a cost recovery basis until December 1997. It is too early in the transition stage to offer any conclusion about whether measures adopted by management to identify and recover these costs are adequate.

20.29 Further details on our audit objectives, criteria and approach are presented in **About the Audit** at the end of the chapter.

Observations and Recommendations

Specifics of the Transaction

20.30 In the sale of CCG, the government sold physical assets, rights and privileges.

20.31 **Physical assets.** Physical assets included fixed assets (mostly printing and office equipment) and the inventories.

20.32 **Rights.** The rights sold were the Logo, the CCG Wordmark and the technology.

20.33 **Privileges.** Under the terms of the agreement, the government implemented the Privileged Administrative Arrangement (PAA), which will allow departments and agencies to do business with St. Joseph Corporation for a period of five years without soliciting bids or obtaining Treasury Board approval for contracts up to \$100,000. Contracts below this threshold represented about 95 percent of CCG's business.

20.34 The agreement also includes Accommodation Arrangements for the purchaser's occupancy of leased space in 60 premises across Canada that were occupied by CCG. This will allow the purchaser to retain the advantage of collocating with its government customers.

20.35 Through these arrangements, the government essentially has recreated the business environment in which CCG operated. It provides the new owner with easier access to government business for five years (in their dealings with contractors other than St. Joseph Corporation, departments are governed by government contracting regulations that require procurement needs for goods and services to be tendered). The government has agreed to explain and promote the PAA as a procurement option for departments and agencies.

20.36 This five-year business advantage, which was offered to all prospective purchasers, will give the winning bidder time to structure its operations to face full market competition. However, the government did not offer any guarantee of business since government departments and agencies still retain the right to choose the best-value supplier for printing services provided that they go to tender should they wish to contract with a contractor other than St. Joseph Corporation.

Sale price

20.37 In consideration for these assets and entitlements, the purchaser agreed to pay or otherwise assume liabilities aggregating \$10.7 million. This sale price comprised a cash payment, assumption of liabilities by the

purchaser and an amount for cost avoidance by the Crown. The detailed breakdown of the sale price is shown in Exhibit 20.4.

Exhibit 20.4

Components of Payment

	\$ millions
Payment in cash	\$5.0
Assumed liabilities	
Accrued vacation	\$0.6
Transfer of rights in software	<u>\$1.4</u>
Subtotal	\$7.0
Cost avoidance in salary offers	<u>\$3.7</u>
Total Price	<u>\$10.7</u>

Source: Office of the Auditor General

Offers of employment

20.38 St. Joseph made 570 offers of employment with a guarantee of employment of two years (551 operational employees of the business units, including 248 at the Main Plant in Hull and 19 from the Corporate Services Division). Further details about offers of employment are given in Exhibit 20.5.

Exhibit 20.5

Status of Jobs Offered by Buyer

	Accepted Offers	Refuse Offers	Total Number of Offers
Operations staff	533	18	551
Corporate services staff	15	4	19
Total	548	22	570

Source: Public Works and Government Services Canada

Sale Process

20.39 Once the decision to investigate the feasibility of privatization had been made, the CCG privatization team led the process. It developed principles to guide management decision making until such time that government direction was received. A team comprising officials from the central agencies, PWGSC and the Department of Justice, supplemented with private sector financial and audit advisors, drafted detailed bid evaluation and selection criteria that were approved by the government. The bid evaluation team also consisted of individuals from different departments. The financial advisor controlled liaison with the bidders.

20.40 CCG followed a competitive sale process and the invitation to submit bids was made through the Open Bidding System, the government's electronic advertising system. Exhibit 20.6 shows the different stages of the sale process.

Exhibit 20.6

Chronology of Sale Process

Stages	Date
1. Treasury Board approval of the process	16 May 1996
2. Invitation to submit bids (360 interested parties)	13 June
3. Prequalification (86 potential buyers)	13 June - 16 August
4. Non-binding process (23 bids received, 7 selected for next stage)	Due 21 August
5. Binding offers (5 submissions)	Due October 16
6. Evaluation of bids (3 finalists)	16-30 October
7. Selection of best bid (St. Joseph Corporation)	31 October
8. Final due diligence	4 November - 12 December
9. Negotiations of terms and conditions for agreement	November
10. Treasury Board approval	12 December
11. Agreement of Purchase and Sale	13 December
12. Job offers to operations staff	6 January 1997
13. Job offers to corporate services staff	14 February
14. Closing of deal	7 March

Bid evaluation

20.41 Given the government conditions of sale, best value was obtained. CCG hired a private sector financial advisor to assess the value of the business units to be sold and to advise on the sale strategy. According to the advisor, the real value of CCG, as a government common services agency, resided in its proximity to customers (collocation), its goodwill, its experienced employees with strong client relationships, employee security clearances and, most important, the ability of government departments and agencies to procure from CCG without tender.

20.42 At the same time, however, CCG did not have significant assets such as real estate, as it occupied government-leased premises. Although its printing equipment was well maintained, it was not modern. CCG was incurring losses. Its only client was the Government of Canada. However, with sales of nearly \$100 million in 1995-96, we estimate that CCG retained about 20 to 25 percent of the government printing business market share.

20.43 The government ruled out the option of offering long-term contracts to the purchaser or offering a guarantee of business. Although such an offer might have generated a higher selling price, it would have been inconsistent with Treasury Board common services policy and would have limited the ability of government departments and agencies to choose the best-value suppliers.

20.44 Nonetheless, in order to sell under the best conditions possible, the government offered some transitional incentives to prospective purchasers in the form of special access to all departments and agencies, as described earlier.

20.45 The government set a minimum expectation or preference for the sale of CCG units — minimum of 400 job offers (150 at the main plant in Hull) for a minimum period of two years, and an amount of \$13 million cash or equivalent benefits or savings for the government. The St. Joseph Corporation bid met the government's expectations.

20.46 In taking into account Work Force Adjustment costs for employees not offered a job and special incentives payments made to employees who accepted a job, the best-value bid would be the one that resulted in the least cost to the government. Factors other than cost, including financial capacity, the quality of jobs offered and risk factors, were also taken into account. Points were attributed to both cost and other factors, and the St. Joseph bid scored the highest number of points.

20.47 After the evaluation of the bids had been finalized, CCG found out that it had overstated the value of the St. Joseph bid by \$464,000. This was caused by an incorrect classification in CCG's human resources records of certain employees between operations and corporate services. CCG recalculated the bid's points and concluded that the overstated amount was insufficient to offset the point advantage of the St. Joseph's bid over the next finalist's bid. This increase in the net implementation cost of St. Joseph's bid was not reflected in the information provided to the Treasury Board. However, the full impact of Work Force Adjustment costs of accepting the St. Joseph Corporation bid were calculated and disclosed to the Treasury Board.

Sale process properly managed

20.48 In conclusion, we noted that the sale process was properly managed, transparent and open to all potential buyers. We found support and documentation on all aspects of the process. All potential buyers received the same information, and the evaluation and selection criteria were applied consistently to all bids received.

20.49 In our opinion, the evaluations of both non-binding and binding offers were conducted in accordance with the stated process and resulted in a proper evaluation of the bids.

Final terms and conditions of the deal

20.50 Before closing the deal in March 1997, CCG and St. Joseph Corporation made an amendment to the Agreement of Purchase and Sale and, as a result, the number of job offers to be made for corporate services employees was reduced from 30 to 19. We were informed that only 19 individuals who had the skills needed by the purchaser were available to transfer to St. Joseph Corporation. The savings in Work Force Adjustment costs of 11 job offers were calculated at about \$150,000 during the bid evaluation process. Again, even if that fact had been known at the time of bid evaluation, it would not have changed the result of the competition. But, as a result of this amendment, the government will pay some extra Work Force Adjustment costs for individuals who will not find a job elsewhere in the government. However, we consider that this amendment resulted from a negotiation process that is normal in such a transaction. We were advised by CCG that only a few of the corporate services employees will not find a job elsewhere in the government and will thus be entitled to Work Force Adjustment benefits.

20.51 In conclusion, we found that the evaluation of the business units carried out by the financial advisor to assist the government in designing the privatization plan and the resulting valuation report were most useful. We believe that the approach used for estimating the fair market value of each business unit (discounted unlevered free cash flow method) was the most appropriate method, given the history of CCG's lack of profit.

20.52 As discussed earlier, the divestiture process was competitive and attracted a significant number of bidders from the printing industry. We concluded that, despite the modifications noted above, the bid submitted by St. Joseph Corporation represented the best value that could be obtained at that time under the parameters and conditions of sale specified by the government. A corporate profile of St. Joseph Corporation is included in Exhibit 20.7.

Exhibit 20.7

Profile of the Successful Bidder - St. Joseph Corporation — (before acquiring CCG)

- Canadian, family-owned business founded 40 years ago
- Based in Toronto
- 550 employees and annual sales of \$120 million
- Customers include large corporations as well as governments and Crown corporations
- Advanced printing operation at leading edge of technology
- ISO 9002 designated company
- By acquiring CCG, St. Joseph Corporation is virtually doubling in size and will have offices across Canada

Human resources records

20.53 In a privatization process, human resources are an important part of the value of the business that is for sale, and the number of resources that can be absorbed by prospective purchasers is a significant element of the value the government is obtaining from the purchaser in terms of costs avoidance. It is therefore critical to have accurate and complete records about the work force for the prospective purchasers to prepare their bids. The data about CCG's work force were not adequate for the special needs of the privatization (support of bid evaluation and job offer processes). This caused several problems during the entire process.

20.54 In future privatizations, special attention should be paid to human resources records and specific measures should be taken early in the process to ensure the accuracy and completeness of the records to facilitate the sale process.

Benchmark used for bid evaluation

20.55 A general test applied to the sale of a government entity is that the government should receive greater value from the sale than it would receive from retaining ownership, taking into account the financial and other implications attached to continued ownership.

20.56 One of the options that the government examined for CCG was downsizing the organization. In analyzing this option, the government assumed that CCG would continue as a special operating agency with certain operational modifications, that is, the size of its work force would be reduced and CCG would be allowed to use more efficient pricing strategies to compete with the private sector for government business. This option is known as the competitive model.

20.57 The government used the net implementation cost of the competitive model as a benchmark to assist in evaluating the bids. In the event that it became apparent during the sale process that the government would not get

at least what was expected under the competitive model, CCG would have to return to the government for further direction on its future.

20.58 We found that the calculation of the net implementation cost of the competitive model used as a benchmark during the bid evaluation process was questionable. The portion of the cost of the competitive model relating to future annual operating results took into consideration only financial forecasts for the next three years (discounting period) where losses were expected. CCG's calculation did not include the present value of future annual cash flows following the discounting period for which profits had been forecast. The other bidders without doubt considered profitability on a longer term than CCG did.

20.59 A method similar to the one used in the valuation report prepared by the financial advisor, adding terminal value and discounting operating results over a longer term, may have been more appropriate for the calculation of the net implementation cost of the competitive model to obtain a benchmark more comparable with bids received.

20.60 For future privatizations, the government should ensure that bids received are compared with reliable benchmarks that have been thoroughly assessed and reviewed.

Control over Transfer of Assets

20.61 We found that there was satisfactory control over the transfer of the CCG's assets and liabilities to the purchaser. Adequate revenue and expense cut-off procedures were used at closing to ensure that the government collected what it had earned and paid only its own costs to the date of transfer. The net book value of assets sold amounted to \$7.4 million (\$4.6 million for inventories and \$2.8 million for capital assets).

20.62 PWGSC Real Property Branch took the necessary measures to arrange for 60 accommodation leases at fair market value with St. Joseph Corporation.

20.63 One problem was encountered before the privatization process began. The asset records and the physical asset count done by CCG in preparing for the privatization could not be reconciled. Assets of \$350,000 were written off. These were items with a book value exceeding \$1,000 each.

Costs of Privatization

20.64 The December 1996 estimate of the privatization costs provided by CCG was \$45.3 million. This amount included costs of the sale of CCG's business units, the transfer to government departments of the functions not privatized, the closing down of the special operating agency, as well as Work Force Adjustment costs and operating losses incurred during the privatization period. We have not audited these costs. Exhibit 20.8 gives the breakdown of the privatization costs.

Exhibit 20.8

Estimated Costs of Privatization (not audited)

For the privatization period from 1995-96 to 1997-98

	\$ Millions
Work Force Adjustment costs ¹	38.1
Operating losses incurred	7.9
Project management costs ²	11.7
Transition costs ³	15.1
Gross Costs of Privatization	72.8
Realization of net assets and liabilities ⁴	(20.5)
Proceeds from sale	(7.0)
Net Cost of Privatization	45.3

Notes:

¹Details given in Exhibit 20.9.

²Costs incurred for planning and implementing the privatization decision (major components are the Privatization Secretariat, the Privatization Implementation Group and the management of Human Resources).

³Various costs incurred as a result of the privatization of CCG's business units, of the transfer to government departments of some functions and of the closure of the remaining CCG's functions (type of expense includes, for example, the six month salaries for job search paid to corporate services employees not hired by the purchaser and salaries paid to some operations employees in the months preceding their departure or retirement).

⁴Mainly accounts receivable net of accounts payable.

Source: Public Works and Government Services Canada

20.65 The organization had started to downsize in 1995 and related Work Force Adjustment costs are included in the cost of privatization. The total costs of Work Force Adjustment and Special Incentives programs appear in Exhibit 20.9. These costs will be absorbed by the CCG revolving fund.

Exhibit 20.9**Work Force Adjustment Costs 1995-96 to 1997-98**
(not audited)

	December 1996 Estimate \$ Millions
548 Employees Accept Job Offers	
Compensation for accepting different benefits	10.0
Salary top-up	0
Severance pay	6.1
Unused vacation	<u>1.9</u>
Subtotal	18.0
183 Employees Receive Early Retirement Incentives	
Pay in lieu of unfulfilled surplus period	4.0
Severance pay	4.3
Unused vacation	0.2
Separation benefit	<u>1.4</u>
Subtotal	9.9
239 Employees Receive Early Departure Incentives	
Lump sum payment as a compensation for leaving	6.8
Severance pay	2.2
Training allowance	0.5
Unused vacation	0.5
Service allowance	<u>0.2</u>
Subtotal	10.2
Total Work Force Adjustment Costs	38.1

As at 31 March 1995, there were 1,080 CCG staff. In addition to the 970 who have left CCG, 80 transferred with the functions retained by the government and 30 have found or are seeking alternative employment.

Source: Public Works and Government Services Canada

20.66 Other costs resulting from the privatization and not included in the above-noted estimated figure will be absorbed by the government.

Waiving of actuarial reduction on pension allowances

20.67 The actuarial estimate made by the Treasury Board of pension penalties waived for government staff taking early retirement is \$125,000 per employee. We estimate that for CCG the cost ranges from \$20 million to \$25 million; this money will come out of the government superannuation account. Although CCG disclosed the fact that eligible employees of CCG would have access to the pension waiver, it did not provide estimates of the costs. The inclusion of this cost element would bring the total cost of privatization between \$65 million and \$70 million from CCG's latest estimate of \$45 million.

20.68 In addition, costs related to waiving of pension penalties were not included in CCG's analyses of the various options for the organization's future. The inclusion of this cost element could have had an impact on the results of the cost/benefit analyses conducted.

Pension protection clause

20.69 CCG employees who transferred to St. Joseph had to leave their pension with the government superannuation account. The government designed and implemented a pension protection clause for employees transferred to the private sector. In virtue of this clause, these employees will have their period of service with St. Joseph Corporation added to their period of service with the government for the purpose of determining pension eligibility. This means that a certain number of employees will be eligible for their pension earlier than if this clause had not been approved. (The government pension plan stipulates that an employee is entitled to an unreduced pension if he or she has a minimum of 30 years of service and is at least 55 years old; otherwise the employee has to wait until the age of 60 to get an unreduced pension.) This provision is another cost to the government superannuation account that has not been included in the calculation of divestiture costs.

Income tax considerations

20.70 The purchase price includes a cost avoidance item of \$3.7 million, the value of making offers of employment to 552 employees at 100 percent of prevailing salaries instead of 86 percent as initially bid. This is the amount that the government would have had to pay to employees if the offer had remained at 86 percent. Indeed, the calculation of this amount reflects the fact that the CCG Work Force Adjustment program would have required the government to assume salary differences for periods up to 18 months.

20.71 We saw no evidence that the Crown analyzed the tax implications of this element or other elements of the price structure and their potential impact on government tax revenues.

20.72 **In future privatizations, cost/benefit analyses of options and cost estimates prepared by the government should include all direct and indirect costs to be absorbed by government departments and entities to the extent that they are material and can be practically assessed.**

Human Resources Considerations

Work Force Adjustment program

20.73 In April 1993, CCG became a separate employer under the *Public Service Staff Relations Act*. CCG employees had different classifications and salary scales than the rest of government. Also, because CCG was a separate employer, the Treasury Board Work Force Adjustment Directive did not apply to its employees.

20.74 The Treasury Board, CCG and the unions worked at establishing a Work Force Adjustment program for CCG. As a result of a series of government decisions between February 1995 and December 1996, the CCG program contained provisions very similar to those of departments and agencies subject to the Treasury Board Work Force Adjustment Directive. It included a provision for a lump sum payment of six months' pay to employees who accepted a job offer from the purchaser, to compensate for differences in the purchaser's pension plan and in other benefits. It also contained provision for the payment of severance pay at lay-off rates, which is the highest rate for severance pay. Exhibit 20.9 provides the breakdown for Work Force Adjustment costs.

Early Retirement Incentive program

20.75 The Early Retirement Incentive (ERI) compensation regulations became effective for Public Service employees on 1 April 1995. By amendment to these regulations, ERI compensation was extended to CCG employees on 15 June 1995.

20.76 On 15 July 1995, the Chief Executive Officer (CEO) of CCG guaranteed ERI compensation to 50 key employees if they were eligible as of that date and if they remained on staff until privatization. The granting of ERI compensation to others was restricted by CCG in October 1996, because the number of employees remaining was approaching the level needed to maintain CCG as a viable entity.

20.77 Using the Treasury Board model as a guide, we determined that the CCG Work Force Adjustment program was adequate and our test on a sample of cases revealed that they complied with the conditions of the program.

20.78 The ERI program was in place for employees who would not be offered employment by the purchaser. Thus the CEO's guarantee of ERI compensation to 50 employees would appear to be an inconsistent application of the program. However, the ERI regulations specify that eligibility may be extended by the deputy head as required to meet operational requirements. The guarantee by the CEO meets this condition.

20.79 The October 1996 restriction on granting ERI compensation is reasonable. It was done to maintain CCG as a viable operational entity and in anticipation of offers of employment being made by St. Joseph Corporation to a substantial number of employees. Such offers, when made, would negate eligibility for ERI compensation. Those not receiving such offers would continue their entitlement to compensation.

Job offers

20.80 In general, we found that the approach to determining the final number of people receiving offers from the purchaser was fair and consistent.

20.81 The job offers by St. Joseph Corporation were 100 percent of substantive salaries. The letters of offer to employees conformed with the Agreement of Purchase and Sale.

Conflict of Interest Policies

Employee takeover groups

20.82 The sale process allowed employees to submit bids. Employee takeover (ETO) groups were reimbursed up to \$25,000 for expenditures on financial and legal advice required to develop their proposals. Their bids were considered at the same time and on the same basis as all others. The "Code of Conduct for CCG Employees" was in force and CCG issued "Supplementary Guidelines Regarding Employee Takeover Groups" in 1996. Employees

were required to certify that they had read the Code and to disclose any activity that could place them in a situation of conflict of interest, such as participation in an ETO group.

20.83 Certain participants in ETO bids who occupied sensitive positions within CCG were temporarily reassigned to PWGSC by CCG in order to protect the integrity of the sale process and the employees from potential criticism.

20.84 We found that CCG's policy adequately described the risk management measures for ETO bids, and those measures were applied.

Individuals involved in the privatization process

20.85 St. Joseph Corporation needed personnel in areas such as human resources, information technology and finance to complete its management team for the newly acquired entity. It therefore made offers of employment to corporate services employees in February 1997.

20.86 After the Agreement of Purchase and Sale was signed (13 December 1996), St. Joseph Corporation approached the Crown for permission to make job offers to two employees with close involvement in the privatization process. The Crown gave the Corporation this permission. We found that, while CCG obtained legal advice and took precautionary steps, these individuals participated in some discussions toward the end of the process, before closing of the agreement (7 March 1997).

20.87 CCG advised us, however, that from the moment these individuals were approached, they participated only in providing information and not in any decision making affecting the remainder of the privatization process (for example, the job offer process, and compliance with closing conditions). We noted that while the appearance of some conflict of interest existed, there was no evidence of any actual conflict occurring.

20.88 While we recognize that one objective of the privatization was to transfer as many jobs as possible to the purchaser, individuals having a sensitive role in a privatization process and who accept an offer of employment from the purchaser should not be allowed to participate in any further discussions with the purchaser, in order to remove any appearance of and potential for conflict of interest.

Experience in Other Jurisdictions

20.89 Privatizing government internal services organizations is complex because the business units to be sold are not always adequately defined or severed from the rest of the government. The process is also difficult because of the various stakeholders' objectives and the sometimes conflicting interests.

20.90 Other countries have privatized their internal printing services. We are aware of at least two examples where difficulties encountered in the privatization process led to full inquiries: the British government's sale of Her Majesty's Stationery Office (HMSO) and the privatization of the Government Printing Office in New Zealand.

20.91 In the case of HMSO, press reports indicated that the sale price was less than a third of that initially expected and the successful buyer was allowed extra time to renegotiate the price after being named the preferred bidder. A month after the privatization, the new company announced that the work force would be reduced by more than a third and that additional work force adjustment costs for staff could not be ruled out. The National Audit Office has confirmed that it is carrying out a full inquiry into the transaction.

20.92 Similarly, the Government of New Zealand inquired into the circumstances surrounding the sale of its printing office. Concerns were raised about the length of time it took for the process, which caused additional costs for the government and led to a reduction in the sale price.

Conclusion

20.93 It is too early to predict whether the privatization of CCG will be a success in the longer term and whether all of the obligations under the agreement will be met. However, our review of the privatization process shows that it was open and transparent and that it was properly managed within the context of the sale conditions of the government.

20.94 The government had to consider various stakeholders' interests, such as value for the taxpayers, fairness for the prospective purchasers and employees, and jobs for employees. These objectives and considerations sometimes conflicted and their resolution depended on the respective weight placed on them. From a public policy perspective, fairness and jobs were important factors, but resulted in costs (such as Work Force Adjustment costs) exceeding those that would have been incurred in a private sector transaction.

20.95 The privatization was achieved within a reasonable period of time. The initial target was to complete the sale within 36 months. The period was revised to 19 months and it actually took 25 months to privatize CCG from the Budget of February 1995 to the closing in March 1997. Delays encountered were, among other things, to ensure that the government could comply with its various trade agreements, and comply with the Work Force Adjustment program, which requires that employees be given 60 days to analyze job offers and make a decision.

20.96 Completing a privatization in the shortest possible period is essential because of the uncertainty that such a process creates and the difficulty of maintaining the morale of the work force, as well as the challenge of maintaining the business volumes (especially for an optional service), which are essential to obtain maximum value for the entity. CCG's gross revenues generated by the business units that were sold went from \$97.7 million in 1995-96 to \$80.1 million in 1996-97 (on an annual basis). This represents a reduction of 18 percent for the last year of operation.

20.97 **Some key success factors.** The following factors contributed to the overall success of the privatization of CCG.

20.98 The fact that CCG was established as a special operating agency in 1990 allowed better severance of the organization from the rest of government and provided CCG with some valuable experience in operating in a quasi-commercial environment as a stage on the way to privatization.

20.99 The identification and resolution of authority and policy issues and the extensive consultation conducted with all stakeholders before starting the sale process were essential, especially as there was no previous government experience or privatization framework to draw upon.

20.100 The openness and transparency of the process was a success factor.

20.101 The many dimensions of an exercise such as this one require diversified expertise. The presence of advisors from central agencies and other departments as well as external consultants to give advice on legal, financial, audit and fairness matters contributed to the results.

20.102 Responsibility was given to the privatization team to make or obtain decisions related to the sale of CCG and to resolve procedural difficulties as they arose. This reinforced accountability for results in this privatization endeavour.

About the Audit

Objective

The objective of our audit was to examine the privatization of the Canada Communication Group in order to determine whether appropriate procedures were followed to protect the interests of the government and taxpayers and to ensure that the process was well managed, open and transparent. We also wanted to identify the key lessons learned from the privatization.

Scope

Our examination focussed on the period from May 1996 when the privatization process was approved to the actual transfer to the purchaser on 7 March 1997. The scope of the examination did not include the decision to privatize. It consisted of interviews with CCG management and other involved parties, the review of relevant documents and the tests that we considered necessary.

We did not audit any of the bidders and accordingly express no opinion on their activities.

Criteria

- Sale Process

We expected that the sale process would be well managed, open and transparent.

- Bid Evaluation

We expected that the best-value bid would be the one that resulted in the least cost to the government, and that non-cost factors would also be considered in determining the best bid.

- Control over Transfer of Assets

We expected that there would be adequate procedures and controls in place to monitor the transfer of assets and to ensure that there has been a correct allocation of revenue and expenses between CCG and the buyer.

- Costs of Privatization

We expected that the costs would be appropriately disclosed to decision makers.

- Human Resources Considerations

We expected that an approved Work Force Adjustment program would be implemented consistently across the Agency, and that conflict of interest would be appropriately managed.

Audit Team

Janet Hatt

For information, please contact Alain Boucher, the responsible auditor.

Chapter 21

Household Goods Removal Services of the Federal Government

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Household Goods Removal Services of the Federal Government

Assistant Auditor General: David Rattray

Responsible Auditor: Vinod Sahgal

Main Points

- 21.1** This audit was conducted in response to a request from the Standing Committee on Public Accounts.
- 21.2** Some 19,000 employees were moved by the federal government in 1995-96 — one quarter of all moves by the van lines in Canada and several times more than the next-largest Canadian employer. The federal government is well placed to obtain favourable terms from the moving industry.
- 21.3** The tariff paid by the government has been falling significantly in recent years. A number of factors have contributed to this decline, including introduction of the competitive bidding process in 1992. The tariff is below that paid by all but a few Canadian organizations procuring similar services. Nevertheless, there are a number of areas that warrant action.
- 21.4** The level of satisfaction of government employees with the quality of service was below that of relocated employees of other Canadian organizations. One reason is that emphasis has been placed mainly on obtaining the lowest price, not the “best value” — a concept based on both price and quality as measured in terms of employee satisfaction.
- 21.5** The existing contracting arrangements, which incorporate a formula for allocating business among qualified bidders, have proved to be brittle. For two consecutive years, problems have arisen in either the tendering or the implementation phase.
- 21.6** A potential exists for overcharging due to “weight bumping” as well as excessive weight for other reasons. The inherent risk that billed weights can be manipulated is high, yet controls to prevent this are weak.
- 21.7** The number and cost of personnel employed to administer household goods removal activities have not been falling despite the significant decline in volume of moves. Potential efficiency gains have been identified that could achieve savings of an estimated \$1.5 million yearly. Enhanced use of information technology, centralization, simplification of rules and regulations, and elimination of unproductive activities are some areas that need action.
- 21.8** There are other areas of potential cost savings. For instance, yearly savings of \$1 million to \$2 million in operating costs may be possible if a feasible alternative to weighing shipments can be found for pricing moves.
- 21.9** The employment of several former senior National Defence officials by the moving industry has created a perception of non-arm’s-length relationships. Further, a specific situation being looked at by National Defence may determine whether or not any abuse actually occurred.

Introduction

Government moves of household goods involve several players

21.10 For 30 years the Government of Canada has operated a central system of contracting for the relocation of household goods. The system is overseen by the Interdepartmental Committee on Household Goods Removal (IDC), chaired by National Defence (DND) and comprising DND, the RCMP, and Public Works and Government Services Canada (PWGSC).

21.11 Treasury Board issues the Relocation Policy that governs the relocation of government employees of departments, agencies and Crown corporations as listed in the *Financial Administration Act*. DND and the RCMP have their own policies for the relocation of their members. The IDC establishes the Statement of Work for transportation services. PWGSC is the contracting authority and is responsible for establishing contract requirements. Each IDC member department is responsible for the administration of contracts (including the ordering of moves, audit and payment of invoices).

21.12 There are approximately 3,000 carriers of household goods in Canada; about 500 of them are affiliated with van lines. There are four major van lines in Canada, each comprising a number of carriers. Originally, the main function of the van lines was to co-ordinate trips to and from a destination so the carrier did not return empty. Because the federal government contracts mainly with the van lines instead of with individual carriers, van lines are the prime contractors for government work and the carriers or agents are subcontractors.

21.13 Approximately 60 percent of federal government moves are made in three summer months, June to August. Some of the capacity built up to handle this peak load may understandably be underused in the rest of the year.

21.14 All federal government departments and agencies cover the costs of relocating the household goods of staff who have been assigned to new locations. In 1995-96, by far the largest number of moves was undertaken by DND (14,000), followed by the RCMP (2,200). PWGSC managed 2,600 moves for other departments.

21.15 The number of moves has been declining in both the government and the private sector (Exhibit 21.1). During this period of decline, the federal government's share of moves handled by van lines has remained fairly constant at about one quarter of the total number (Exhibit 21.2).

Exhibit 21.1

(This exhibit is not available, see the Report)

Exhibit 21.2

(This exhibit is not available, see the Report)

Focus of the audit

21.16 On 20 June 1996 the Standing Committee on Public Accounts wrote to the Auditor General and asked him to investigate specific matters associated with the federal government's household goods removal services. The Auditor General responded on 8 July 1996, agreeing to conduct a value-for-money audit of household goods removal services that would include the specific matters raised by the Committee (see Appendix for the exchange of correspondence).

21.17 Further details on the audit objectives, scope, criteria and approach can be found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Value Obtained under Contracting Arrangements

21.18 Some 19,000 employees were moved by the federal government in 1995-96 — one quarter of all moves by the van lines in Canada and over 18 times more than the next-largest Canadian employer. The federal government is well placed to obtain favourable terms from the moving industry.

Prices paid by the government are comparatively low

21.19 From 1989 to 1996, the tariff paid by the federal government for the relocation of household goods showed a cumulative decrease of about 30 percent in current dollars, or close to 50 percent in 1989 constant dollars adjusted for inflation (Exhibit 21.3). However, prices negotiated for 1997-98 are higher on average than the previous year's by about 14 percent.

Exhibit 21.3

(This exhibit is not available, see the Report)

21.20 Changes made in the government procurement system in 1993 and 1995 contributed to the decline in tariff. Other factors at work include the deregulation of the industry coupled with a rapid decline in the number of moves in the federal government and elsewhere, and a consequent overcapacity in the industry.

21.21 The federal government pays a tariff significantly lower than the tariffs paid by other organizations we contacted. No other organization in Canada contracts for anything close to the number of moves by the federal government, so one would expect the tariff it pays to be relatively low.

21.22 The federal government's transportation costs have not declined as much as tariffs, since the average weight of a household of goods has risen over the same period. From 1993 to 1996, the average weight of government shipments increased (Exhibits 21.4 and 21.5). It is reportedly now slightly higher than in the corporate sector. Average weights for both government and corporate moves are in the order of twice the average for moves paid for by individuals. Industry officials attribute this difference partly to the fact that when individuals pay they are far more selective in what they choose to move.

Exhibit 21.4

Comparison of Total Cost, Total Weight, Number of Moves, Average Weight per Move and Average Cost per Move

	1993-94	1994-95	1995-96	Percentage Increase (Decrease) 1993-94 to 1995-96
Total Cost (in \$000s)	\$ 88,558	\$ 79,093	\$ 68,884	(22.2)
Total Weight (in 000s of pounds)	155,345	146,471	145,338	(6.4)
Number of Moves	22,933	20,505	18,855	(17.8)
Average Weight per Move	6,774	7,143	7,708	13.8
Average Cost per Move	\$ 3,862	\$ 3,857	\$ 3,653	(5.4)

Between 1993-94 and 1995-96, the number of government moves of household goods decreased by 17.8 percent. However, during the same period, the average weight per government move increased by approximately 13.8 percent.

Note: Comparable data for 1996-97 were not available at the time of the audit.

Source: IDC

Exhibit 21.5

(This exhibit is not available, see the Report)

Greater emphasis on employee satisfaction needed

21.23 From our review of best practices in other Canadian organizations as well as in selected organizations in other countries, we noted that in almost all cases the notion of “best value” is the primary consideration in the contracting process — where “best value” is based on both price and quality as measured in terms of employee satisfaction.

21.24 We found that the federal government has given this aspect less attention. It has defined quality of service largely as the carrier’s conforming with specified standards, for example, for packing and unpacking. The IDC has used an employee feedback form to ascertain satisfaction with moves, but this information has been collected inconsistently and has not been analyzed sufficiently.

21.25 PWGSC assesses the contractor’s broad capability to comply with regulations governing move procedures, but not its past performance in terms of customer satisfaction with completed moves. A bidder on a contract must obtain a minimum number of technical points but, after this initial screening of eligibility, employee satisfaction in the past has had limited influence on who is awarded how much work. There is little incentive provided to movers to ensure that government employees are fully satisfied.

21.26 From our look at best practices, we concluded that there are a number of ways information on customer satisfaction can be used in the contracting process — by providing a pricing incentive or penalty; by providing an increased share of business, particularly by granting more off-peak business to contractors that deliver good customer satisfaction; by considering the past track record of customer satisfaction when awarding each contract; or by tracking customer satisfaction with different contractors and providing the information, with a choice of contractors, to the relocating employee or the employer.

Employee satisfaction is below that of other organizations

21.27 We conducted a survey to assess the extent to which federal government employees were satisfied with the quality of their household moves. The survey addressed several aspects such as the pre-move briefing, the packing, loading, unloading and unpacking of their furniture and effects, and the claims settlement process.

21.28 We found that about two thirds of those we surveyed were satisfied or very satisfied; 18 percent were neither satisfied nor dissatisfied; and 14 percent were either dissatisfied or very dissatisfied. Many factors can influence satisfaction, including whether or not the move is voluntary, but to have one in seven employees dissatisfied or very dissatisfied indicated room for improvement. Dissatisfaction was highest with unpacking and claims settlement. According to the IDC, the recent decline in the settlement amount (see paragraph 21.102) could reasonably be seen as a contributing factor.

21.29 We compared levels of satisfaction between government employees and employees of other organizations. Because of differences in the survey methodologies, only limited comparisons are possible. Given this limitation, it appears that government employees were consistently less satisfied than employees of other organizations with the quality of the moving service, by a notable degree (see Exhibit 21.6). The government has not specified what level

of customer satisfaction it expects. However, it expects that its development of performance measures will help to establish benchmarks for customer satisfaction.

Exhibit 21.6

(This exhibit is not available, see the Report)

Fairness and competitiveness of the system are at issue

21.30 The present contract framework to allocate business shares was introduced for the 1996-97 contract year based partly on the advice of the Competition Bureau. Until the current inquiry by the Competition Bureau is completed, the appropriateness of the business allocation system remains an open question.

21.31 In May 1996, the Bureau started an inquiry into allegations that one or more of the van lines had breached a 1983 order issued by the Supreme Court of Ontario by preventing affiliated carriers from providing services to the federal government except through van lines. The four major van lines reportedly had entered into agreements to provide moving services to each other in areas where they were not represented, but would not enter into similar agreements with any other bidder on the federal government tenders.

21.32 Without commenting on competition issues presently being pursued by the Bureau, we can make some observations. With the exception of one competitive element, the PWGSC system of procuring relocation services for household goods is a “managed” system of work sharing. The work is allocated on a percentage basis among a small number of contractors. Whether the eligibility-to-bid requirements constitute significant barriers against new suppliers, especially smaller businesses, is also an open question. The system’s one competitive element is that the largest share of business goes to the low bidder. Once the low bid is identified, the other bidders are asked to match it. PWGSC has sought a maximum of four bidders (a minimum of three) who are willing to match the low bid price, based on the IDC’s belief that there is insufficient capacity with fewer than three suppliers.

21.33 We have several concerns about the workability of the process. First, as we have noted, price and not “best value” is the key determinant in allocating business among competing bidders. Employee satisfaction is not built into the selection of contractors.

21.34 Second, the bidders are not asked what percentage of government moves they can handle, and the lowest bidder is not necessarily awarded a volume of business to the full capacity that it is willing to commit to government work. Bidders cannot offer different prices for different volumes of work or different levels of service, or for sub-packages of particular types or locations of moves. To participate in the work, bidders are required to meet the low bid price even though they may differ in their particular competitive advantages, volumes of work and levels of service. Smaller organizations that might be very capable of handling moves in one zone (say between Quebec and Ontario) are not able to bid on that basis. The “me too” concept does not match a particular carrier’s capability with a particular move, nor does it sort moves into packages that might economically be handled together. However, DND is not convinced that changing its current approach would necessarily lead to better value for money.

21.35 Third, if contractors participate in the bidding process their only option is to bid as if they had the capacity to undertake the largest percentage of the work, although some do not have that capacity. Therefore, some may bid high enough to ensure that they do not win. They want to be in a position to match the low bidder, but for a smaller share of work. This gives the appearance, but not the reality, of full and open competition. Indeed, it would appear that only two bidders have been interested in obtaining the largest share of business, so only those two bids have been aggressively priced.

21.36 Fourth, the contract could be more flexible. There is a need to encourage further innovation and piloting of new ideas. For instance, it may be timely to try other options for pricing moves (paragraph 21.98).

21.37 Finally, the bidding system has proved to be brittle. The structure depends on a sufficient number of bidders who both are qualified and agree to match the low bid. This has led to difficulties in the tendering process.

21.38 In tendering for the procurement of the household goods removal services for 1996-1997, for example, the government evaluated the capacity of the bidders to provide the required services. The low bidder, who was a new entrant, was reportedly unable to perform to the government's full satisfaction. Shortly after the start of the contract, the bidder was informed by PWGSC that it was non-compliant, due to alleged non-performance by a subcontractor. Rather than face contract termination for default, the low bidder changed subcontractors to one of the van lines that had been unsuccessful in the original bidding.

21.39 In 1997, the same bidding process was followed. Again, problems resulted. This time only one other bidder was willing to match the low bid. Negotiations led to various changes that had the effect of increasing the previous year's tariff by about 8 percent before the third van line would agree to a new contract. The unsuccessful bidder challenged the process in court. Subsequently, a still higher price (by 14 percent) was negotiated, along with some changes in the percentage shares of work.

21.40 In addition to these questions about the workability of the bid matching approach, there are concerns about fairness. On the basis of its experience with the tendering process, PWGSC now believes that "the bid matching process is fundamentally unfair in that contractors are obligated to provide services at the lowest bidder's rates, regardless of their volume of business share."

21.41 A further concern of some in the industry is that contract awards have been announced about two months before the start of the contract period. Industry personnel argue that this provides insufficient time to adjust to potentially large changes in business share, and that this risk, too, may serve as a barrier against the entry of new suppliers. However, in the latest procurement the government let a two-year contract, which may provide for longer lead times at the next competition.

21.42 The business allocation system needs to be re-examined. A number of alternative contracting structures are possible that could encourage more competitive bidding and service innovation (see Exhibit 21.7).

Exhibit 21.7

Some Alternative Systems of Move Management

Our discussions with industry and our review of best practices suggest that weaknesses in the present contracting structure could be resolved. We identified a number of potentially attractive alternatives, each with some advantages and disadvantages:

- **Segmenting the national contract into a number of packages.** Rather than a single national contract, the work could be subdivided into a series of packages based on traffic patterns (for example, one package might consist of all moves within a single region, another of all moves between that region and another region). Among other advantages, this would open up competition to firms not able to provide service nation-wide.
- **Tendering individual moves.** Another possibility is to tender each move separately, a practice used by Removals Australia, an agency that arranges government moves in Australia. The potential advantage is that attractive prices might be obtained if the tendered shipment could be loaded on a truck that would otherwise travel partially or entirely empty. One potential disadvantage is the cost of administering separate tenders for each move (although experience in Australia suggests that this need not be significant).
- **Developing a standing offer list of firms.** Rather than negotiate a large-volume contract, firms would provide a quote on the services they offer and their associated rates. Government departments and/or relocating employees could choose from among the available firms. Information could be added on levels of client satisfaction with each firm in previous moves. The U.S. General Services Administration has established such a system for use by U.S. federal agencies. This raises the question of whether firms not guaranteed specific business would offer a price and service combination different from what they would provide under a large-volume contract?
- **Providing lump sum payments to employees as an alternative to a government-paid move.** This approach, which could be provided to employees as a voluntary option, involves giving a non-accountable allowance to employees, who then directly engage

a moving company or rely on 'do-it-yourself'. A pilot of such a system undertaken by DND concluded that the option was not viable. Our review of the pilot suggests, however, that the option could be considered for employees who are interested, even if this is a small proportion of government employees, at relatively little administrative cost and risk.

Source: OAG review of best practices

21.43 Public Works and Government Services Canada, in consultation with the Interdepartmental Committee on Household Goods Removal Services, should implement a fairer and more effective contracting arrangement that:

- **gives greater weight to employee satisfaction with past moves in determining “best value”;**
- **improves the fairness and competitiveness of the contracting arrangements, including concerns that may be raised by the Competition Bureau; and**
- **allows for innovation and piloting of new ideas.**

Cost and Efficiency of Household Goods Removals Management

21.44 Household goods removal services are managed in-house at DND, RCMP and PWGSC, all members of the IDC. Apart from co-ordination through the IDC, each department manages its moves independently of the others, with activities split between headquarters and regional offices across Canada. DND has a network of 29 regional offices, RCMP has a separate network of 13 offices and PWGSC has 9, for a total of 51 regional offices.

21.45 The activities performed by each of the departments at its headquarters include planning and overall monitoring of the activities that are contracted out, and supervising those carried out in-house by regional offices. The activities in the regions include registering all information related to moves, communicating with contractors, providing assistance to relocating employees, monitoring and controlling services performed by the contractors and verifying invoices. In PWGSC all invoices are verified and paid centrally.

Studies have been undertaken to improve efficiency and reduce costs

21.46 The IDC has been examining ways to reduce the cost of managing the household goods removal services since the early nineties.

21.47 Between 1991 and 1994, the IDC initiated three studies to analyze the cost of managing household goods removal services and to identify potential savings. One aspect examined was whether it would be more cost-effective to contract out certain activities to the private sector or to continue to manage them in-house. An interdepartmental senior review board concluded, based on the studies, that a business case could not be made to contract out the management and delivery of the services and that in-house efficiency gains should be pursued.

21.48 The last internal study undertaken by the IDC on the cost of managing household goods removal services was performed in 1994. The study showed that it cost about \$5.6 million in direct expenditures (salaries and benefits) to manage 22,933 moves in 1993-94, reportedly involving some 123 full-time equivalents (FTEs). The cost per move at that time was \$242 and the number of moves per person employed in the function was 186.

21.49 We reviewed the IDC's most recent information on the cost of managing household goods removal services at DND, RCMP and PWGSC. The total cost was \$5 million in direct expenditures (salaries and benefits) for 1996-97, involving the equivalent of some 110 person-years (67 military personnel and 43 civilians). The IDC has very limited performance measures for assessing the efficiency and effectiveness of its activities.

21.50 In 1995, a series of negotiations took place between DND and PWGSC on transferring the latter's move-management responsibilities to DND in order to consolidate management activities in one location to minimize overlap in responsibilities and duplication of work. This consolidation had not taken place at the time of the audit. In addition, discussions have begun for the transfer of the RCMP responsibilities to DND.

Government's management costs per move are comparatively high

21.51 The number of personnel and the total direct expenditures for managing the household goods removal function have remained more or less constant from 1993-94 through 1995-96, while the number of moves has sharply declined (see Exhibit 21.8).

Exhibit 21.8

Cost and Resources Used for Managing Household Goods Removal Services from 1993-94 to 1996-97

Year	No. of Moves	FTEs	Cost ¹	Cost/Move	Moves/FTE
1993-94	22,933	123	\$5.6 M	\$ 242	186
1994-95	20,505	123	\$ 5.6 M ²	\$ 271	167
1995-96	18,855	123	\$ 5.6 M ²	\$ 295	153
1996-97	*	110	\$ 5.0 M	*	*

Notes:

- 1 Cost of salaries and benefits of personnel directly involved in the function.
- 2 Departmental estimates of salaries and benefits of employees directly involved in the function, based on an internal study done in 1994.
- * The number of moves for 1996-97 was not available at the time of the audit.

Source: IDC management information systems and DND internal studies

21.52 DND told us that it plans to continue to pursue additional efficiencies. In 1995, DND began in-house development of the Automated Move Management System (AMMS), aimed at moving from a largely manual system to a paperless contracting, invoicing and payment system. This system was expected to be operational on 1 April 1998; the most recent projection by DND is that the project will be completed by April 1999. The improved Automated Move Management System is now expected to save at least 30 full-time equivalents.

21.53 Industry officials informed us that van lines fully support the government's plans for automation. However, in their view the entire process needs to be reviewed before any further investment is made in developing the proposed system. They recommend continued and further consultation with industry on both process and technical design.

21.54 Some private sector organizations gave us data on the costs of managing their household goods removal services. One reported its average cost per shipment handled in-house at about \$200, while another reported a range of \$150 to \$180 — both lower than in the federal government.

21.55 Fees charged by third-party companies generally range from \$200 to \$350 per move, depending on volumes and levels of service. It is important to note that reported federal government costs involve only salaries and benefits, not overhead costs, while third-party fees cover all costs and some provision for a profit margin.

21.56 As a further example, Removals Australia appears to manage a larger number of moves than the Canadian federal government on a somewhat smaller total budget. It should be noted that Removals Australia is a special agency of the Australian national government that handles all aspects of household moves for all federal government departments as well as other levels of government.

Household goods management control activities do not always meet expectations

21.57 We noted that the extent of the activities conducted across the three departments is uneven. Furthermore, a number of activities are not being carried out at all. For example, quality control inspections and reweighs (described in paragraphs 21.83 - 21.89) are not being performed by the RCMP and PWGSC, and the reweigh program at DND is performed only in a small number of locations and in a very limited way.

21.58 Exhibit 21.9 shows our analysis of the differing activities carried out by DND, the RCMP and PWGSC. Our own view is that these differences among departments in most cases call for one of two possible courses of action — either decide that an activity is necessary and provide it consistently, or decide that it is not needed and eliminate it.

Exhibit 21.9

Extent of Services Provided

Expected Performance	Actual Performance		
	DND	RCMP	PWGSC
• Customer Survey Report:			
- distribution to employees	Y	Y	Y
- tabulation of results	N	N	Y
• Log registering complaints regarding the quality of service provided	X	N	N
• Inspections and audits of contractors' premises and records	N	N	N
• Quality control inspections (QCIs)	Y	N	N
• Liquidated damages	Y	X	N
• Warehouse inspections	Y	Y	*
• Reweigh program	X	N	N
• Invoice verifications	Y	Y	Y

Y: Performed as per contract expectations

N: Not being performed

X: Inconsistent performance

*: Performed by DND's employees

Source: 1996-97 tariff agreement between the Government of Canada and contractors for the provision of household goods removal services

21.59 Results of our review of best practices suggest that not all of the activities provided are essential. In particular, quality control inspections and warehouse inspections are not performed by the vast majority of other organizations we examined. As one major public sector organization noted, relocated employees are their “quality control inspectors”, through the mechanism of monitoring customer satisfaction and incorporating the results in the contracting process. Some of the more notable move management practices used by other organizations are described in Exhibit 21.10.

Exhibit 21.10

Notable Move Management Practices Used by Organizations We Contacted

- Almost all organizations we contacted centralized household goods removal activities in a single department of the organization, and most co-ordinated other aspects of the relocation process, such as home sale, within that same unit.
- Only two of the organizations co-ordinated move management from geographically diverse locations.
- The majority of our participants allowed the employee the choice of carrier.
- Many of the organizations we spoke with found that allowing the employee and the carrier to negotiate a specific delivery date resulted in a greater level of customer satisfaction, and significantly less demand for storage in transit.
- One organization conducts a phone estimate with each employee in advance of the carrier estimate. This serves to provide a means of validating the carrier-provided estimate, and also serves to identify up front any unusual circumstances pertaining to the move. In another organization, employees are required to complete a detailed information package, in which they: list their furnishings and effects; provide a valuation of their goods being shipped; identify any special requirements; and indicate the dates on which they would like their goods both loaded and delivered.
- Several firms keep employee move “histories” - key data on previous moves, including weight moved. These firms use this history as a means of validating the weight of the current move, since significant increases in weight may be an indication of weight bumping.
- One firm is making extensive use of the Internet as a means of communicating with the service providers, and has found that this represents a cost-effective and reliable means of keeping in touch with the carrier.
- Several other organizations, particularly third-party move-management firms, maintain management information systems more advanced than the federal government’s, and were able to provide information tailored to specific client need.
- Several organizations conduct client satisfaction phone surveys with their employees within 48 hours of move completion, and believe that this yields a high rate of return as well as more timely information.
- One organization has made provisions for the performance of on-site quality assurance inspections in locations away from its headquarters by having these inspections performed by independent third parties located in the vicinity of the shipment, at a cost of \$50 per inspection.

Source: OAG review of best practices

21.60 In addition to consolidating management activities in one department (see paragraph 21.50), there are possible benefits to be gained from centralizing geographically. A decision to no longer conduct quality control inspections and warehouse inspections would eliminate much of the need to keep staff at various locations throughout the country. The federal government is one of the few organizations that does not manage household goods removal services from a single location. People in the industry whom we interviewed would prefer to see administration and service delivery standardized across all departments, and management activities centralized to eliminate duplication, wherever practical, and to better control the balance between price and service levels.

21.61 Some industry officials believe that aspects of the current structure are necessitated by the rules, regulations and reporting requirements involved in federal government moves. They argue that many of the steps in the process, such as warehouse inspections and attendance at employee homes, do not add sufficient value and have

simply become entrenched over time. Industry officials maintain that some of these steps do not reflect common practice in the private sector and represent higher costs of compliance for industry.

21.62 A number of officials in the moving industry also indicated that because of high turnover of key federal government staff involved, the level of knowledge about industry practices has suffered. For example, the Chair of the IDC has changed yearly for the past few years. If the federal government could find a way to control the frequency of staff rotation, it could increase expertise and provide continuity in management.

21.63 In our view, given the number of opportunities for improving the efficiency of move–management activities discussed in this section of the chapter, savings are possible in the order of \$1.5 million out of the \$5 million spent annually on the administration of household goods removal.

21.64 Industry officials noted that the cost of moving federal employees could be reduced further without adverse impact on service, in areas such as less storage in transit and the spreading of the workload more evenly during the busy summer months when the majority of moves understandably take place. DND and the RCMP believe that while this may be true, this kind of action could have a significant negative impact on morale and operations.

21.65 An improved performance measurement and reporting system is needed. We found that little performance data on cost and quality had been collected or used by management for 1996-97 due to computer system failures at DND. Early in our audit, the IDC informed us that developing a good performance information system was among its top priorities, and IDC actively participated in our benchmarking exercise as a way to make progress in improving its own performance measurement and reporting systems.

21.66 Senior management needs to consider carefully the future direction of the management of household goods removal services in the federal government. The management information systems in place are functioning only partially, and the Automated Move Management System is still in the pre–operations stage, as discussed in paragraph 21.52. Officials have postponed the transfer of the PWGSC responsibilities to DND that had been agreed to in 1995. Contracting out the management of the household goods removal function remains an option to consider.

21.67 **The Interdepartmental Committee should act to strengthen and improve the efficiency of the household goods move–management function, including:**

- **implementing an improved performance measurement and reporting system;**
- **making greater use of information technology for communicating with contractors, and for providing management with timely information;**
- **minimizing overlap in responsibilities among National Defence, the RCMP, and Public Works and Government Services Canada; and**
- **reconsidering the need for existing move–management activities such as inspections of warehouses and attendance at employees’ homes.**

Managing the Risk of Overcharging

21.68 The issue of “weight bumping” was raised by the Public Accounts Committee as an area of specific concern to be addressed by the Auditor General. The Committee made reference to the 28 November 1995 segment of the CBC television program “Marketplace”, which raised the possibility that weigh scale tickets could be manipulated to the carrier’s advantage.

The inherent risk of overcharging is high

21.69 We have identified four key factors that led us to the conclusion that the inherent risk of overcharging due to the possibility of weight manipulation is high. Those factors include compensation schemes for drivers, lowering of government tariff rates, a decrease in the number of government moves of household goods, and relaxation of certain regulations in the 1996-97 contract.

21.70 Compensation schemes for drivers. Many drivers are paid a significant percentage of the amount billed. The amount billed is mainly a function of the weight of the shipment. There are many opportunities for drivers who might wish to manipulate recorded weights to their advantage. Exhibit 21.11 lists some examples of some methods a driver could use to manipulate the gross weight shown on a weigh scale in a way that inflates the net weight of the household goods.

Exhibit 21.11

Methods a Driver Could Use to Manipulate the Gross Weight Shown on a Weigh Scale

- When the tare weight is obtained, no individuals (movers) are in the truck; however, when the gross weight is obtained, individuals are in the truck.
- When the tare weight is obtained, have the fuel tanks empty; when the gross weight is obtained, have the fuel tanks full.
- Prior to obtaining the gross weight, add items to the truck that are not part of the government shipment being billed.
- When the tare weight is obtained, remove the spare tire; however, put it back on before obtaining the gross weight.
- Obtain a weigh scale ticket that is not preprinted and/or on which the weight identified is not printed by the computer.

Source: United Van Lines (Canada) Ltd. Scale Report 1996

21.71 Lowering of government tariff rates. The decrease in government tariff rates in recent years can put pressure on a carrier's profit margin, increasing the inherent risk that weights may be manipulated for billing purposes. This is particularly true in situations where the carrier is significantly dependent on government business.

21.72 Decrease in the number of government moves of household goods. The significant reduction in the number of government moves in recent years could also reduce the income earned from government moves, thus increasing the inherent risk of manipulation.

21.73 Relaxation of certain regulations in the 1996-97 contract. The government allowed some of the regulations to be relaxed in the 1996-97 Tariff Agreement. We noted that the 1996-97 Tariff Agreement did not specifically provide penalties for weight bumping, such as suspension of a carrier. As a result, there is less to deter drivers from manipulating the system. Also, we noted that a two-hour "window" was added for the driver to unload before contacting the destination base. This was introduced at the request of industry to minimize waiting. However, this could allow a driver who may wish to hide a weight bump to do so more easily.

21.74 It should be noted that under the present system the ultimate control over this risk resides with the integrity of the driver.

Controls to manage the risks are weak

21.75 In the course of reviewing a representative sample of move invoices to assess the possibility of overcharging, we noted a number of cases in which existing controls were not effective because they were not well designed, had been ignored or were not applied with sufficient rigor. While not significant individually, taken together they indicate that controls to mitigate the risk of overcharging may not be working as well as intended.

21.76 Under section 34 of the *Financial Administration Act* (FAA), the Deputy Minister or an authorized representative is responsible for ensuring “that the work has been performed”. In the movement of household goods this means, among a number of things, ensuring that the proper weight was reported by the driver and subsequently billed by the prime contractor. Departments are expected to have in place satisfactory financial controls and procedures to ensure that the invoices received from contractors are processed in accordance with their policies and procedures.

21.77 The main control procedures to ensure that the proper weight was billed are the verification of weight on invoices against weigh scale tickets, payment of no more than 110 percent of the estimated weight, billing for liquidated damages in cases where weight “errors” are detected, DND’s reweigh program, and quality control inspections.

21.78 Weight scale tickets. The current system of invoice verification and the fulfilment of section 34 requirements rely heavily on the validity of the weigh scale tickets. According to DND, the “accuracy of the ticket is of prime concern. Accordingly, tickets must be from a government–certified scale, completely filled out and be the original signed copy provided by the scale operator.” In our view, information on weigh scale tickets is unfortunately not always a reliable, independent basis for payment.

21.79 Some examples of weaknesses in the way the controls are applied included a case where the driver submitted a weigh scale ticket with a gross weight that was used for billing purposes. However, the weigh scale operator’s copy did not have a gross weight entered. As noted above, the amount of the payment is based on the weigh scale ticket. In one case, the weigh scale ticket was reported lost, and therefore no payment should have been made. However, the invoice was paid by the government based on an estimated weight, without sufficient and independent verification that the work had been performed to the extent reported.

21.80 We also noted an instance where a photocopy of the ticket rather than the original was the only support for billing.

21.81 Payment of no more than 110 percent of the estimated weight. The departments attempt to limit their exposure to potential weight bumping by limiting the amount the government will pay in any one move to 110 percent of the original estimate of weight. However, our discussions with industry officials suggest that the tendency has been to overestimate the weight of shipments. We noted that one estimate was increased during a move at the request of the carrier without sufficient explanation or documentation to justify it. The 110 percent maximum payment rule has limited value as an effective control to minimize the risk of overcharging.

21.82 Liquidated damages in cases where discrepancies are detected. In years prior to 1996-97, “fines” ranging from \$10,000 to \$25,000 in the form of reduced business and suspensions could be imposed on contractors in cases where errors in weighing were detected by the government. However, in the 1996-97 Tariff Agreement this regulation was relaxed to change the fines and suspensions to a penalty–like system called “liquidated damages”. Liquidated damages are fines levied on contractors for violating contract conditions. These fines are either flat amounts up to \$1,000, and/or certain amounts per day, item or pound of infraction. However, liquidated damages are not as severe as the previous penalties and therefore the deterrent effect is lessened. Furthermore, the lengthy process for establishing the damages reduces their impact. For the contract year 1996-97, a total of \$392,000 was established as liquidated damages. As of 31 March 1997, \$22,000 had been collected. DND officials informed us that at that date a large portion of all identified liquidated damages had yet to be invoiced. Liquidated damages, therefore, have provided limited control against the risk of weight manipulation.

21.83 DND’s reweigh program. DND’s reweigh program is another means to minimize the risk of weight bumping: a sample of shipments are reweighed under the supervision of a trained employee at destination. The objective is to verify that the driver’s weigh scale ticket obtained at origin has not been manipulated.

21.84 On one reweigh we witnessed at the point of destination, the driver had not obtained weigh scale tickets at the origin. Therefore, the transportation agent was unable to assess whether a weight manipulation had occurred.

21.85 During the course of conducting our tests, we noted cases where individuals performing the reweigh did not appear to have sufficient and appropriate training and experience.

21.86 Our concern is that the existing reweigh program is also largely ineffective as a control against weight bumping, for two main reasons. First, the driver is not required to declare to the government the weight of the shipment at the point of origin to allow for a proper comparison with the result of the reweigh at destination. Second, the number of reweighs actually performed is insufficient: fewer than 0.2 percent of moves were reweighed and in many locations no reweighs were performed at all.

21.87 Quality control inspections to ensure that proper weight was established. Trucks are required to be weighed twice prior to leaving the city of origin — once when empty and again after loading. DND's quality control inspections check for compliance with a number of the rules and regulations contained in the government tariff, including ensuring that the truck's fuel tanks are full. This is designed to minimize the risk that the driver can manipulate the weight of the shipment by refuelling after the original weighing. Although control inspections are conducted after the truck is loaded, they are not conducted between original weighing and loading. Quality control inspection is therefore limited as a control procedure because it addresses only one opportunity for manipulating weights.

21.88 Overcharging can also be due to excessive weight on account of unusual items included in shipments. We identified some apparently unusual, albeit "admissible" items, particularly in the case of shipments to overseas locations. We asked DND whether there is an opportunity here to save on costs. DND officials told us that the carriage of such items is consistent with policy and is not considered inappropriate.

21.89 None of the three departments involved in the supervision of moves critically reviews inventory listings for unusual or non-admissible items. In many cases, such items would not be detected because the listings are not always sufficiently descriptive of the nature and volumes of items carried.

Overcharging may have occurred

21.90 The sample of invoices we reviewed to assess the potential for "weight bumping" and higher-than-normal weight due to other reasons was limited to three of the four contractors. Although the fourth one indicated that it would be "co-operative and compliant", it also noted that it would agree to the involvement of designated representatives, including members of our Office, but would "object to other industry members' involvement". Our audit procedures required that industry experts assist us in estimating the weight of specific items. Therefore, without involving other industry members, we would be unable to complete our audit procedures for the sample items related to that contractor. Accordingly, we did not examine that contractor's records and cannot draw any conclusion about the appropriateness of the weight recorded.

21.91 It is the position of PWGSC (the contracting authority) and DND that the government have full and free access to the records of all four contractors as it deems necessary to audit their invoices. Following our advice, the government has now obtained records from the fourth contractor; however, the government has decided not to analyze at this time the charges billed by this contractor.

21.92 Our sample of moves of household goods was selected from the population of moves between 1 April 1996 and 31 December 1996. The examination was not designed to reach conclusions about individual shipments but rather to identify bias, if any, in the aggregate amount of billed weight. The methodology for determining our estimate of the shipment weight on a per-item basis was developed in consultation with the van lines. The basis for estimation was a standard weight assigned for each type of item normally carried.

21.93 Based on the testing of a sample of invoices from three of the four contractors, on an aggregate basis the weight billed exceeded our estimate of the aggregate weight of shipments moved. The extent of the identified bias is statistically significant.

21.94 We discussed this observation with the three contractors. They agreed that using the methodology designed for this audit, the number and extent of variances in weight we found could reasonably lead to our overall conclusion at the aggregate level. However, the testing did not, and could not, demonstrate that there was any deliberate attempt by contractors or their agents to alter weights of shipments in order to receive higher payment from the Government of Canada. There is nonetheless a very real risk of recording excess weight, due either to weight manipulation or to the shipment of unusual items as previously described, given the high inherent risk and the weaknesses in the systems and controls in place as we have already noted. As a result, the perception remains that the potential for weight bumping still exists.

21.95 It should also be noted that the average weight per government move has increased by approximately 14 percent since 1994. The trend in the corporate sector is reportedly not as high. DND informed us that the increase in average weight can be attributed to several factors; given that an increasing number of its personnel live in private dwellings rather than military housing where major appliances are provided and basements are often unfinished, and that a higher proportion of personnel are married, it views the rise in shipment weights as reasonable and expected. There was no analytical information available to measure the impact of the above factors and we could not determine the extent to which the increase could be attributed to weight manipulation, if at all.

21.96 Removals Australia appears to avoid controversy about potential weight bumping. It obtains a detailed inventory from the relocating employee before calling for bids and, on the basis of that inventory, estimates the volume of the household goods to be moved. Carriers are asked for a fixed-price bid based on this volume rather than on the shipped weight. If subsequently there are significant changes to the inventory list, the carrier may negotiate a price change with Removals Australia.

21.97 In our view, if the government continues to use weight as one criterion (along with distance) to determine price, it needs proper controls to ensure that the price it pays is the correct price, that is, based on the correct weight. Certain controls have been established that, as our audit has shown, have not been used correctly or adequately. It could be argued that, at a minimum, these controls should be applied more rigorously. However, the other important question is whether the controls can actually ensure correct weight, and consequently correct payment. There appear to be too many systemic problems and costly procedures associated with accurately measuring weight to use it as a basis for pricing moves.

21.98 All four van lines and the IDC agree on the need for a simple and auditable method for pricing moves of household goods — one that reduces the risk of error, the risk of weight bumping, and the cost of controls for both the government and the industry. Savings of \$100 per move in operating costs — \$1 million to \$2 million a year — are viewed by some industry officials as entirely realistic, provided there is no significant offsetting expense involved in the new basis for pricing moves.

21.99 We followed up with RCMP headquarters the specific allegation raised by the CBC television program “Marketplace” about the alleged overcharging for an RCMP move. Officials informed us that the local police force where the incident occurred was still investigating. They further informed us that any decision to follow up on such matters rests with each divisional Commanding Officer but, while concerned about the impact of weight bumping, in their view the risk is not high.

21.100 Public Works and Government Services Canada, in consultation with the Interdepartmental Committee and the moving industry, should minimize the risk of overcharging due to weight bumping and strengthen the auditability of invoices from contractors. Consideration should be given to introducing an alternative to the existing basis for pricing moves or, in the absence of workable alternatives, implementing a satisfactory reweigh program.

Insurance claims declined in 1995-96

21.101 Between April 1992 and March 1996, nearly one third of all relocated government employees received an insurance claim settlement.

21.102 On behalf of the IDC, PWGSC undertook a study in 1996 to address the Public Accounts Committee's concern about potential claims abuse. Our examination was limited to a review of the PWGSC working papers and report, which found that the average settlement amount for insurance claims from federal employees decreased by 26 percent — from \$762 in 1994-95 to \$558 in 1995-96 — although the average settlement, the frequency of claims and the number of items per claim remained higher than in the industry in general.

21.103 Moreover, the report found that the cost of insurance services had declined by about 15 percent between 1992-93 and 1996-97. The federal government's average cost per claim is higher at \$558 than that of a number of private sector organizations that reportedly average \$435.

Insurance claims abuse is not excessive

21.104 PWGSC also reported that of the claims filed by federal government employees, 19 percent are potentially exaggerated or fabricated in some manner. PWGSC concluded that this rate is similar to the private sector and that the cost of applying further controls would not likely be recovered through lower settlement amounts. Of these potentially abusive claims, on average only 37.5 percent of the amount claimed was actually paid.

21.105 It should be noted that these findings are based on a limited-scope study: an examination of claims for one van line, with the largest percentage of business for 1995-96. The other van lines to which the remaining business was allocated were not examined due to the cost and complexity of this review. We concluded that the incidence of potential abuse and waste in the area of insurance claims is declining. This conclusion was corroborated by senior industry officials.

Potential for Conflict of Interest

21.106 The Public Accounts Committee referred to "the potential existence of non-arm's-length relationships between the moving industry and the Interdepartmental Committee (IDC), the committee responsible for moving contracts."

21.107 We examined the risk associated with the relationship between the moving industry and officials of DND, the RCMP and PWGSC who form the IDC. We focussed on the allegations made in testimony before the Public Accounts Committee on 31 October 1995 stating that certain former government officials were in a conflict-of-interest situation. We also reviewed the departments' compliance with the government's conflict-of-interest and post-employment policies and procedures. Our review as such was limited to assessing the potential for conflict of interest.

The risk of conflict of interest is changing

21.108 Based on the Treasury Board Conflict of Interest and Post Employment Code and the respective codes that apply to members of DND and the RCMP, we assessed the risk of potential conflict of interest on the part of public officials in relation to household moves. We looked at the opportunity for particular officials both to influence a decision and to obtain personal gain as a result. We considered the risk on the job and in post-employment.

21.109 There is always some risk that members of an organization can influence contract specifications in favour of established contractors, which potentially gives them an advantage after leaving employment. In post-

employment the potential exists, particularly for former IDC members, to influence government officials to maintain contract specifications and operational requirements that favour established contractors. This risk is increased if former IDC members do not respect the government's post-employment codes.

21.110 The risk regarding IDC members relates mostly to potential impact on competitiveness. We noted that the Competition Bureau is examining the competitive aspects of the way the federal government purchases household goods removal services; the results were not available to us during our audit. The employment of several former senior DND officials by the moving industry has created concern in some quarters that fair and open competition is affected. Partly in response to such concerns, the IDC requested that PWGSC take over the function of contracting with the moving industry. This recent event has changed the risk of potential conflict of interest between IDC officials and the household goods moving industry by establishing a separation of responsibilities. As PWGSC takes increased leadership in the contracting process, this risk should become lower.

21.111 PWGSC supply officers do not appear to have had a significant impact on defining operational requirements for household goods removal services, nor are we aware of any having taken employment with the moving industry after leaving the public sector.

21.112 Staff who administer individual moves in each IDC member department have potential opportunities for personal gain by influencing the quality, quantity and selection of quality control measures, including inspections. However, they do not have as much influence as members of the IDC to warrant preference in offers of employment from the moving industry.

21.113 Specific allegations. We reviewed the details of allegations of conflict of interest included in parliamentary records and in documents provided to us by the Public Accounts Committee. In total, we reviewed the circumstances of 14 former DND officials associated with the IDC, 11 of whom had chaired that committee or were subject to the government's codes. In addition to the requirements of the federal government's codes, we noted that in 1989 DND put in place Supplementary Compliance Measures pursuant to section 11 of the government's Conflict of Interest Code. DND had files for 8 of the 14 cases, which we reviewed. In the other 6 cases the conflict-of-interest code was not applicable. We found that DND had properly applied its conflict-of-interest and post-employment code, including the Supplementary Compliance Measures, to the senior officials who took employment with the moving industry. Based on our review of the 8 cases, we found no evidence to support the concern that officials of DND were in a non-arm's-length relationship with the moving industry.

21.114 Representations from deputy ministers. As part of our approach we sought confirmations from the deputy ministers of DND, the RCMP, and PWGSC of actions they have taken in response to concerns of potential conflict of interest, and any knowledge they may have of such situations. Such representations are significant, in that they require the most senior departmental officials to ensure that codes of conduct are complied with. We therefore expected that they would disclose any information related to the subject under review that in their opinion warrants the attention of our Office. We received responses from all three departments confirming that their policies, practices and codes have been complied with, and stating that they were not aware of any conflict of interest between their officials and the moving industry.

21.115 On 16 July 1997 DND informed us that on 8 May it had received information from another agency suggesting that in 1994 a sensitive protected document that originated in that agency may not have been given appropriate care while in the possession of National Defence staff. The Department is still looking into this allegation and has indicated that it will advise us further.

21.116 Interviews with senior officials responsible for overseeing conflict-of-interest policy. We met with the conflict-of-interest officials at DND, the RCMP, and PWGSC. We reviewed the details of their policies and their application to the circumstances under review. We confirmed with each of them the official representation sent to us.

21.117 In summary, we have determined that PWGSC, the RCMP and DND have applied the Conflict of Interest and Post-Employment Code appropriately in the situations that we reviewed. Any potential for conflict of interest, including non-arm's-length relationships between government officials and the household goods moving industry, is changing. This is partly attributable to the recent transfer of responsibility for contracting from the IDC, which is chaired by DND, to PWGSC. A final conclusion can be drawn only after the matter under review at DND is resolved.

Conclusion

21.118 There is scope to improve value for money in a number of areas.

21.119 The tariff paid by the government for household goods removals has been declining in recent years. Nevertheless, we have concluded that the contracting arrangements in place need strengthening. The business allocation formula used to distribute business among qualified contractors has proved to be brittle. Least cost and not best value has been the primary basis for allocation of business. Major stakeholders are seeking a better alternative to the current contracting arrangements.

21.120 The government's costs for managing household goods removals have not been falling commensurate with the significant decline in the volume of moves. There are several areas where changes in management and operating policies could result in improved cost and quality of service.

21.121 The government has identified potential opportunities to save some \$1.5 million yearly by improving efficiency in managing the services. Enhanced use of information technology, centralization, simplification of rules and regulations and more attention to customer satisfaction are areas that need action.

21.122 The management of the risk of overcharging due to "weight bumping" and the carriage of unusual items needs to be strengthened. The inherent risk in this area is high; the systems and controls in place to prevent abuse are not working as intended. While it is extremely difficult to determine the precise nature and extent of overcharging that may be occurring, our analysis points to a systemic upward bias in the aggregate weight billed in 1996-97. The government recognizes the problem and has indicated that it will seek to create workable solutions with all stakeholders in consultation with industry. Further, savings of \$1 million to \$2 million in operating costs can be achieved if a basis for pricing moves is found that eliminates the requirement for weighing shipments.

21.123 The potential for claims abuse is not excessive. Finally, the potential for non-arm's-length relationships between the moving industry and the IDC remains, but the risk is changing.

Response from the Department of National Defence, Public Works and Government Services Canada and the Royal Canadian Mounted Police: The taxpayer receives good value for its money and we are pleased that the Office of the Auditor General recognizes that we receive significantly lower prices for household goods removal services. Nevertheless, the OAG's recommendation to place more emphasis on employee satisfaction may have merit. Where feasible and cost-effective, it is our intention to place greater emphasis on employee satisfaction as a factor in the performance measurement framework.

This audit found no evidence of weight bumping. However, we are committed to mitigating this risk and continue to strengthen controls through such measures as increased inspections and reweighs.

The report observes that the average weight per government move is increasing. The government's average weight per move is still less than half of the entitlement. This increase is a result of socio-economic factors and of entitlement and policy rather than transportation pricing, contracting and controls.

The report also observes that the potential risk of non-arm's-length relationships between the moving industry and government employees is changing. The management and contracting responsibilities for household goods removal services are now separated. In addition, the OAG has observed that Treasury Board's Conflict of Interest and Post-Employment Code policies are being appropriately applied. These two factors have reduced the risk of non-arm's-length relationships.

We continually seek to improve how we administer the household goods removal business and have worked closely with the OAG audit team to that end. Outlined below is the plan to achieve the following objectives:

- strengthen the contract framework*
- improve management efficiencies*
- pursue potential additional savings*

A. Strengthen the Contract Framework

Major changes to the contract framework were undertaken in response to Internal Audit and Bureau of Competition recommendations to increase competitiveness, permit new entrants, and reduce the regulations of the industry. These fundamental changes have directly contributed to achieving one of the lowest tariffs in Canada for the past two contract terms. Nevertheless, we agree that the contracting framework can be strengthened. Notably, analysis and alternatives to the bid-matching provisions, opportunities to provide greater emphasis on employee satisfaction in contractor selection/business share allocation, innovation and alternatives to the basis of payment will be sought.

The complexities of contracting for household goods removal services are recognized and the government encourages competition. It is our intention, together with the major stakeholders in the government and the industry, to evaluate potential solutions in a more detailed cost-and-benefit assessment, beginning this fall. It is our intent to examine the impact on rates, in particular in remote and low-volume areas, as well as the increase/decrease of service levels provided to government employees. In addition, any recommendations from the Bureau of Competition will be incorporated into the analysis where feasible.

The current contract expires 31 March 1999. This will provide us sufficient time to assess options with the aim of incorporating changes into the Statement of Work for the next contract.

In the interim, steps have already been taken to strengthen control procedures to reduce the risks associated with the use of weigh scale tickets until a better alternative is found. The reweigh program has been strengthened by increasing the frequency and the RCMP has begun conducting Quality Control Inspections (QCIs). As well, liquidated damages for weigh scale ticket irregularities have been instituted in the 1997-99 contract. Discussions have also taken place with a third-party move-management firm to provide a proposal for an alternative basis of payment for the government's consideration.

B. Improve Management Efficiencies

Currently, based on a Senior Review Board decision, the government has put in place a plan to centralize the management function of household goods removal services and to improve its automation tools. The implementation of the Automated Move Management System (AMMS), scheduled for implementation in April 1999, will result in a marked advance for government to effectively manage household goods removal services and increase efficiencies. The transfer of PWGSC/Central Removal Service (CRS) is planned to coincide with the implementation of AMMS. The AMMS project is currently funded, a team has been established, and the project is progressing on schedule. Discussions have begun with the RCMP to also transfer portions of its responsibilities to DND as an initiative to further eliminate overlaps.

Coincident with progressing on the AMMS project and the development of a PWGSC/CRS transfer implementation plan, an assessment is planned to validate that in-house alternatives remain more cost-effective than contracting the move-management function to the private sector. In addition, the rationale supporting the transfer of PWGSC/CRS to DND will be revisited. These activities are planned to be completed this fall.

The Furniture and Effects Administrative System (FEAS) program currently used to support the management of household goods within DND remains problematic. However, the program is largely functional, with the exception of electronic communication links with contractors, and it is capable of providing some management reports. As a consequence, an assessment is being prepared to determine the possibility of DND using the PWGSC/CRS computer system. The performance measurement project is also nearing completion and will be further enhanced with the implementation of AMMS.

C. Pursue Potential Additional Savings

The OAG suggests additional savings can be achieved through further reductions in Storage in Transit (SIT), spreading moves over larger periods of time and cancelling QCIs and warehouse inspections, together with the creation of an alternative to the current basis of payment. The potential for reducing costs for both the government and for the industry are recognized; however, it must be appreciated that these are only marginal costs, which again suggests that the government is receiving good value for money (i.e. potential savings of \$1.5 million in industry operating costs if a mechanism other than scales is used and if the alternative does not add any other costs). The main cost to government remains that of the tariff and any changes made must ensure that the government continues to obtain a competitive tariff.

With respect to reducing SIT and spreading moves over a larger period of time, significant gains have already been made over the past several years in these areas. Additional substantive gains would not be easily achievable without significant, potentially negative, impacts on morale and could pose operational limitations. This matter will be reviewed.

The need for QCIs, warehouse inspections and establishing an alternative basis of payment can be addressed only within the contract framework. As such, these items will form part of the government's plan to review the contract framework described above.

Within DND, the Cost Move Steering Committee has been re-instituted with its first meeting planned for this fall. Potential options for further reducing SIT and spreading moves is a planned discussion item.

About the Audit

Objectives

The overall audit objective was to assess whether there is scope to improve value for money from the arrangements in place to procure and manage household goods removal services — more specifically, whether:

- present contracting arrangements provide reasonable cost and quality of service and a fair and competitive process;
- the government's management of removal services is economical and efficient; and
- satisfactory controls are in place to guard against overcharging through weight bumping, the potential for excessive insurance claims, and conflict of interest.

Scope

Our audit focussed on those government household goods moves that are the responsibility of the Interdepartmental Committee on Household Goods Removal (IDC). These mainly cover:

- moves handled by the Removal Section of DND and the RCMP;
- those handled by the Central Removal Service of PWGSC (a common service organization); and
- overseas moves that are the responsibility of DND.

Excluded from the scope were domestic moves that are the responsibility of the House of Commons and overseas moves by the Department of Foreign Affairs and International Trade (DFAIT). Also, we did not audit the decision to relocate an employee.

Criteria

The audit criteria were built on the foundation for government contracting as it appears in the Treasury Board Contracting Policy, which points to, among others, the following:

1. The objective of government procurement contracting is to acquire goods and services and to carry out construction in a manner that enhances access, competition and fairness and results in best value or, if appropriate, the optimal balance of overall benefits to the Crown and the Canadian people.
2. Government contracting shall be conducted in a manner that will:
 - (a) stand the test of public scrutiny in matters of prudence and probity, facilitate access, encourage competition, and reflect fairness in the spending of public funds;

- (b) ensure the pre-eminence of operational requirements.

In addition, Treasury Board, in its Comptrollership Policy, requires Departments to establish and document internal policies outlining the extent of accounts verification required, to:

- (a) certify that the work has been performed, the goods supplied or the services rendered or
- (b) in the case of other payment, the payee is entitled to or eligible for the payment.

This Policy also requires that the accounts verification process be audited by the departmental internal audit group.

Approach

We pursued several lines of audit inquiry to answer the following questions:

First, has the contracting arrangement in place resulted in a reasonable cost and quality of service and is the process fair and open?

Second, are the accounts verification processes and related controls operating satisfactorily to guard against overcharging resulting from weight bumping, excessive insurance claims and non-arm's-length transactions, if any, between officials of the IDC and the moving industry?

Third, does the actual cost of the household goods management function reflect the government's own expectations in terms of cost and efficiency, and are the activities carried out as required?

In addition to the above, we benchmarked the government's costs and quality of service with several other organizations that move significant numbers of employees. We also identified best practices in these organizations that could be beneficial to the federal government. Finally, we examined the roles and responsibilities of the key organizations involved with household goods removal to determine whether any significant weaknesses in the government's performance could be attributed to gaps, if any, in accountability.

Our approach was to first determine what actions, if any, have been taken by the government to address concerns that were brought to the attention of the Standing Committee on Public Accounts in 1995. Next, we assessed the nature and extent of actions taken by the government since 1995. Finally, we conducted such tests and procedures as we considered appropriate to assess the systems in place to prevent waste and abuse in the stated areas of concern to the Public Accounts Committee.

We did not conduct an investigation to determine the extent of fraud, abuse or conflict of interest; rather, we examined the government's management practices to assess the potential for such behaviour.

Household goods relocation has been the subject of internal audit and reviews on several occasions; to the extent that the findings of these studies remain relevant, we took them into account. For example, a 1990 internal audit at DND that examined Military Move Claims dealt with important aspects of the relocation of military personnel. Between 1991 and 1994, three studies were initiated by the IDC to analyze the cost of managing household goods removal services and to identify potential savings. In 1996, a review of the 1996-97 process for soliciting and contracting for household goods moving services was carried out by the

Audit and Review Branch of PWGSC. There were no such examinations relating to the accounts verification process.

Audit Team

Manfred Kuhnappel
Neil Maxwell
Jacques Marquis
Martha Lywak
Anne Hardy

For information, please contact Vinod Sahgal, the responsible auditor.

Appendix

Exchange of Correspondence between the Public Accounts Committee Chair and the Auditor General

Letter from the PAC to the OAG, June 20, 1996

Ottawa, 20 June 1996

Mr. Denis Desautels
Auditor General of Canada
Office of the Auditor General of Canada
240 Sparks Street, 11th Floor
Ottawa, Ontario
K1A 0G6

Dear Mr. Desautels,

As you may be aware, the Standing Committee on Public Accounts has developed an interest in the manner in which the federal government of Canada arranges the relocation of household goods of its employees who have been transferred from one location to another.

According to a 1994 estimate, the costs of the moving contracts alone for relocating federal employees was between \$100 and \$120 million. During the same period, it was estimated that the federal government accounted for 30 to 40 percent of the 80,000 to 100,000 total household moves handled by the moving industry in Canada. These data indicate that these relocations represent a considerable cost to federal treasury and to the taxpayers of Canada. They also suggest that actions by the federal government in this area have an impact on the moving services industry as a whole and on the rates paid by individual citizens to have their belongings relocated.

The Committee has studied the matter and has determined that further investigation is warranted. Therefore, as a consequence of the need for further study and of the costs involved in relocating the household goods of government employees, the Standing Committee on Public Accounts is formally requesting that you and your Office examine and report on this aspect of government expenditure. As part of your audit, we also request that you investigate the following elements associated with federal government household goods removal services:

- the potential of claims abuse or “weight bumping,” and, in particular, allegations raised during a November 28 1995 segment of the CBC television program “*Marketplace*”;
- the systems in place to prevent waste and abuse, either by moving companies or by federal government employees;
- the number and cost of both military and civilian personnel employed by the government to manage household goods removals;
- the potential existence of non-arm’s-length relationships between the moving industry and the Interdepartmental Committee (IDC), the committee responsible for moving contracts; and
- the operation of the new business allocation formula, including the criteria — such as the infrastructure in place — employed to select winning bidders, used by the IDC to award moving contracts.

The Standing Committee would also appreciate receiving your suggestions on the steps that could be taken in order to reduce the costs to government and taxpayers of household goods removal services.

Because the issue is serious and the costs considerable, the Standing Committee asks that you give this matter your immediate attention. The Committee’s research staff is prepared to provide any relevant documents that have been acquired in order to assist in the investigation.

In closing, and on behalf of the Committee, I would like to thank you and your Office for the assistance provided to the Committee during the past session of Parliament.

Yours sincerely,

Original Signed by
Michel Guimond, MP
Chairman

Letter from the OAG to the PAC, July 8, 1996

240 Sparks Street
Ottawa, Ontario
K1A 0A6

8 July 1996

Mr. Michel Guimond, MP
Chairman
Standing Committee on Public Accounts
726 Avenue Royale
Beauport, Québec
J1E 1Z4

Dear Mr. Guimond:

Thank you for your letter of 20 June regarding your Committee's request that my Office examine and report on federal government household goods removal services. I am pleased to inform you that we have considered the Committee's request carefully and have decided to conduct a value-for-money audit of household goods removal services including the specific points in your letter.

I have assigned a high priority to the completion of this audit. Accordingly, we will reassess other planned audit priorities in order to report this audit to Parliament at the earliest opportunity. Given the scope of matters expressed in your letter, I plan to report the results of our audit in the first periodic report of 1997 scheduled for tabling in April or May. Meeting this tentative reporting date will depend on the complexity and difficulty of the audit and of dealing with many government departments. Audit work of this complexity requires a minimum of six months field work in addition to planning, report writing and publishing time.

I trust that this will fully meet the Committee's expectations. Should you require clarification on the scope and timing of this audit or on any other matter of interest to the Committee, please do not hesitate to call me.

I would like to take this opportunity to thank the Committee for its interest in the work of the Office over the past year. Your hearings and reports play an important role in government accountability.

Yours sincerely,

Original Signed by
L. Denis Desautels, FCA

cc: Bernard Fournier

Report of the Auditor General to the House of Commons for December 1997

Foreword

I am pleased to table the second volume of my 1997 Report. This Foreword is followed by “Matters of Special Importance - 1997” and the Main Points from all of this year’s chapters. In addition, this volume contains 16 chapters, bound separately:

- Crown Corporations: Making Performance Measurement Work
- Systems under Development: Taking Charge
- Agriculture and Agri-Food Canada - Prairie Farm Rehabilitation Administration
- Citizenship and Immigration Canada and Immigration and Refugee Board - The Processing of Refugee Claims
- Canada Labour Relations Board
- Ozone Layer Protection: The Unfinished Journey
- Fisheries and Oceans Canada - Pacific Salmon: Sustainability of the Resource Base
- Industry Canada - Management of the Small Business Loans Program
- Office of the Superintendent of Financial Institutions - Insurance and Pensions
- Revenue Canada - The Financial Management Regime
- Revenue Canada and Department of Finance - Understanding Changes in Tax Revenues: GST
- The Correctional Investigator Canada
- RCMP Public Complaints Commission
- Follow-up of Recommendations in Previous Reports
- Other Audit Observations

- Sustainable Development Strategy for the Office of the Auditor General

We also issued the first volume of our 1997 Report in October containing 21 chapters.

In addition, this year our Office has provided:

- an opinion and observations on the Financial Statements of the Government of Canada
- an auditor's report and observations on the Debt Servicing and Reduction Account Statement of Transactions
- some 100 auditor's reports and observations on Crown corporations and other entities, territorial governments and organizations and international organizations.

Further, in 1997 our Office completed the special examination of Petro Canada Limited.

Under Section 11 of the *Auditor General Act*, I may undertake from time to time, assignments at the request of the Governor in Council.

Crown Corporations: Making Performance Measurement Work

Assistant Auditor General: John Wiersema

Responsible Auditors: Pierre Serré and Grant Wilson

Chapter 22 - Main Points

22.1 Management and boards of directors of Crown corporations, as well as government and Parliament, require performance information to determine the extent to which expected results have been achieved by Crown corporations. Performance measurement is central to good management and helps fulfil accountability requirements.

22.2 Some Crown corporations are further along than others in developing performance indicators, but the process is under way for all. The experience of those that have moved beyond theory to practical application will undoubtedly be of benefit to those wishing some guidance. We would expect that, if corporations use performance indicators to manage, this should lead to better performance reporting as well as fewer significant deficiencies in the third cycle of special examinations.

22.3 Leadership as well as clear objectives and strategies are essential to support the development of performance indicators by which to assess performance. These indicators can then be used throughout a corporation to align plans and activities with corporate objectives and public policy roles.

22.4 A corporation needs indicators that are complete and balanced to effectively support the alignment of plans and activities with objectives and roles. There are a number of frameworks that can assist a corporation to develop and maintain its set of indicators.

22.5 It is important that boards of directors of Crown corporations use performance indicators in monitoring and evaluating performance and require management to develop and use indicators as a meaningful and integral part of the management process.

22.6 Boards of directors may wish to consider delegating to the corporations' audit committees some responsibility for assessing the state of performance measurement and reporting.

Systems under Development: Taking Charge

Assistant Auditor General: Doug Timmins

Responsible Auditor: Eric Anttila

Chapter 23 - Main Points

23.1 In its efforts to respond to perceived needs of taxpayers and to reduce its costs, the government has undertaken to develop many new information systems. In this audit, we examined three projects that were managed in-house by the departments. We found that they shared similar risks with contract projects, including being late, going over budget and not meeting the needs of users.

23.2 Compared with contract projects, in-house projects were better aligned with the business objectives of the departments and were broken down into more manageable components. In addition, senior management was more involved, communications were more effective and the expertise and experience of the staff were better used.

23.3 Two of the three in-house systems that directly serve Canadians need to reflect a better understanding of who the clients are and what their needs are.

23.4 The disciplines of planning, oversight and quality assurance reduce the risks associated with the business and technical complexity of both contract and in-house projects. However, the three projects that we examined had some deficiencies in these areas.

23.5 A major concern we have reported before is the lack of recording and tracking of actual project costs. Without such tracking, projects can take longer, cost more and deliver less. Although one project was able to provide us with fairly complete estimates, none of the projects could provide precise actual costs. We estimate that each of the three projects we examined will cost the taxpayers between \$50 million and \$100 million.

Agriculture and Agri–Food Canada - Prairie Farm Rehabilitation Administration

Assistant Auditor General: Don Young

Responsible Auditor: Neil Maxwell

Chapter 24 - Main Points

24.1 Over the last six decades, the Prairie Farm Rehabilitation Administration, a Branch of Agriculture and Agri–Food Canada, has adapted its role to the changing demands for reclaiming land, developing water supplies and addressing sustainable development of the rural Prairie landscape. Its familiarity with local conditions, such as the risks of flooding in Manitoba, and its network of offices across Western Canada have enabled it to collaborate with provinces, producers and community–based businesses.

24.2 Although the Branch has adapted to the changing needs of the Prairies, it needs to clarify its strategic direction and priorities, linking its Business Plan, its operational planning and decision making and its financial planning to the results it expects to achieve.

24.3 Consistent with the Department’s transition toward results–based management, the Branch has begun developing a results–oriented, targeted approach to planning and delivering its programs and the rural development agreements in which it participates with others. However, efforts to develop mechanisms to define, categorize, cost and prioritize regional needs within the scope of its mandate need to be accelerated.

24.4 Co–operative working relationships with an extensive network of partners across the Prairies have served the organization well. At the same time, there is an opportunity for the Branch to play a catalytic role of leadership with other levels of government to eliminate gaps in program delivery related to water quality, inventory and supply.

24.5 Approximately 698 full–time–equivalent staff deliver Prairie Farm Rehabilitation Administration programs from 30 offices, at a cost of approximately \$70 million per year. While the Branch has acted on a number of opportunities for cost reduction and cost avoidance, it continues to operate the programs and to plan future activities without reassessing the need for existing resource levels.

24.6 Cost recovery has been implemented for approximately \$10 million of its services, but there is an opportunity to expand these cost recovery initiatives. There is inconsistency in what is presently recovered. We are concerned that the public cost of certain activities may be disproportionate to the public good received.

Citizenship and Immigration Canada and Immigration and Refugee Board

The Processing of Refugee Claims

Assistant Auditor General: Richard Flageole
Responsible Auditor: Serge Gaudet

Chapter 25 - Main Points

25.1 When it signed the *1951 United Nations Convention Relating to the Status of Refugees* and the *1967 Protocol* thereto, Canada undertook to protect refugees. The processing of refugee claims functions in a context characterized by intense and complex migratory movements. In addition, formal procedures must be followed and legal requirements taken into account in order to guarantee compliance with the provisions of the *Immigration Act* and Regulations and the *Canadian Charter of Rights and Freedoms*.

25.2 At the end of 1988, the process had developed a backlog of some 85,000 claims. The system was not up to the task and a radical change was needed. A new structure and a completely revised process for handling claims was put into place in 1989. The expectations were clear: quick, equitable and efficient resolution of claims and the removal of failed claimants.

25.3 We note, however, that Citizenship and Immigration Canada and the Immigration and Refugee Board have serious difficulties dealing with claims quickly and efficiently. We are particularly concerned by the size of the backlog, the lengthy processing times and the difficulty of carrying out removals. We have made recommendations aimed at improving results at various stages in the process.

25.4 Immigration officers rule on the eligibility of a claim without having obtained the required information. Moreover, the information gathered when the claim is received does not serve adequately at other stages in the process.

25.5 The high turnover among members of the Immigration and Refugee Board, and their short terms, have a significant negative impact on achieving targeted results. Moreover, lack of rigour in certain practices slows down the process. The Board has made efforts to improve the process but their success will depend in part on the Board's ability to improve its organizational climate.

25.6 Citizenship and Immigration Canada is having difficulties resolving failed refugee claims quickly and efficiently. The review of risk of return contains ambiguities that raise questions about its merit. We also found a lack of rigour in the assessment of humanitarian grounds for allowing failed claimants to remain. Further, the Department is having serious difficulties carrying out removals.

25.7 Refugee-related questions are complex. A thorough review of the refugee claim process is required — including the division of roles and responsibilities among the various stakeholders as well as the infrastructure of co-ordination and control. However, it is essential that realistic expectations be set for the speed and efficiency of claims processing.

Canada Labour Relations Board

Assistant Auditor General: David Rattray

Responsible Auditor: Alan Gilmore

Chapter 26 - Main Points

26.1 In our May 1995 Report chapter on ethics awareness in the federal government, we proposed that the guiding principle for public office holders be that “public service is a public trust.” The object of the government’s Conflict of Interest and Post–Employment Code for Public Office Holders is to “enhance public confidence in the integrity of public office holders and the decision–making process in government.” We agreed with the general principles of the Code. Of particular relevance to our present audit is the principle that “public office holders have an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.”

26.2 We found that certain financial practices of the Canada Labour Relations Board (CLRB) would not “bear the closest public scrutiny”. Recent reviews of the Board have consistently found major organizational and performance problems resulting, in large part, from an ongoing conflict between the Chair and the Vice–Chairs over control of the work of the Board.

26.3 This dispute has contributed to the undermining of financial and management controls over case processing and scheduling and over travel expenditures. Proposed legislation that failed to pass in the Senate before Parliament was dissolved in April 1997 would have given the Chair authority for “supervision and direction over the work of the Board.”

26.4 After their terms as board members have expired, former board members continue to hear ongoing cases with which they have been involved. However, clear time frames for completing hearings and writing decisions are not established. The cost effectiveness of this type of open–ended appointment of former members is questionable. During the period April 1989 to March 1997, about \$1.7 million was spent for former board members to continue to hear cases. This is equivalent to paying about 14 full–time board members for one year. When their terms expired, a total of about \$595,000 was paid to former board members in severance entitlements and for unused vacation leave.

26.5 Until they were revised in January 1997, certain of the CLRB’s policies on reimbursement of travel expenses for accommodation, food and incidentals were not reasonable or consistent with legislative authority. We also concluded that the Chair’s pattern of expenditures on travel and hospitality is not reasonable.

26.6 We make recommendations to address management and financial control problems in the Canada Labour Relations Board as well as systemic issues involving Governor in Council appointees. We also identify issues that we believe need to be brought to the attention of Parliament at this time.

Ozone Layer Protection: The Unfinished Journey

Commissioner of the Environment and Sustainable Development: Brian Emmett

Responsible Auditor: Wayne Cluskey

Chapter 27 - Main Points

27.1 Because of its northern location, Canada is one of the countries most at risk from the effects of ozone layer depletion, considered one of the most serious global environmental issues to confront humankind. It poses major threats to human health and ecosystems.

27.2 The problem of ozone layer depletion has not been solved. The full recovery of the ozone layer is not predicted for at least 50 more years, assuming full implementation of the *Montreal Protocol*, an international treaty signed by more than 160 countries and aimed at eliminating ozone-depleting substances (ODS).

27.3 Canada has met or exceeded its obligations under the *Montreal Protocol* in each year since it came into effect, according to data compiled by Environment Canada. Canada has also provided assistance to developing countries in their efforts to eliminate ODS. Foreign government officials and experts see Canada as having played a pivotal role in the early development and ongoing evolution of the *Montreal Protocol*.

27.4 Effective enforcement of federal ODS regulations under the *Canadian Environmental Protection Act (CEPA)* is necessary to ensure that phase-out commitments are fulfilled and reported with confidence, as well as to curb illegal trafficking of ODS. We observed several weaknesses in Environment Canada's overall inspection function for ODS regulations under *CEPA*, and believe it is insufficient to ensure compliance with the regulations.

27.5 Canada was among the first countries to put in place a national regime for the recovery and recycling of chlorofluorocarbons (CFCs) aimed at reducing emissions of ODS to the atmosphere, through the implementation of a federal-provincial 1992 National Action Plan. Many of the tasks included in the Plan have been accomplished, including the implementation of regulations in 9 of 10 provinces and the training of more than 75,000 service technicians.

27.6 However, there are significant weaknesses in the Plan, including differences in the requirements among the provincial regulations, and gaps in the measurement of the Plan's results, benefits and costs. These weaknesses underscore the complexities involved in managing a federal-provincial partnership and highlight the need for improved federal government accountability in this regard.

27.7 Public awareness of ozone depletion is high, due in part to sustained educational efforts by federal departments. Recent surveys show that half of all Canadians do not adequately protect themselves during leisure activities. The potential health consequences and costs to the Canadian public should not be ignored.

27.8 Federal departments are substantial users of ODS. Departments we surveyed have implemented strategies to manage their ODS. But they have not met government commitments to lead by example. The federal government has failed to set direction and articulate its expectations for leadership and it has not assigned responsibility to any department for doing this. In effect, no department is in charge.

27.9 If proposed *CEPA* regulations for ODS management at federal facilities are implemented in their current form, and in the absence of any other directive from the federal government, gaps in direction will remain in areas such as phase-out target dates for all ODS applications, the management of stockpiles, ODS conversion to, or replacement with, environmentally acceptable alternatives, and the destruction of surplus ODS. We are also concerned that Environment Canada may lack the capacity to enforce the proposed regulations.

27.10 Ozone layer protection programs in developed countries, including Canada, have lost momentum. Opportunities exist for the federal government to speed the recovery of the ozone layer. Environment Canada has demonstrated an awareness of many of these opportunities. But we believe it needs to set priorities among competing actions, based on sound science and a comparison of their relative costs and effectiveness in reducing risks. Canadian leadership is arguably needed now more than ever before.

Fisheries and Oceans Canada

Pacific Salmon: Sustainability of the Resource Base

Assistant Auditor General: Don Young
Responsible Auditor: John McCullough

Chapter 28 - Main Points

28.1 Canada's ability to sustain the Pacific salmon resource at the present level and diversity is questionable given the various factors influencing salmon survival, many of which are beyond its control. While Fisheries and Oceans has built up major salmon stocks, others are declining and many are considered threatened. There is evidence that habitat loss is contributing to these declines. However, no overall status report on salmon habitat is available to assess the impact of habitat loss on the resource.

28.2 Fisheries and Oceans has a strong mandate in the *Fisheries Act* to protect salmon and their habitat. However, due to the division of environmental powers under the *Constitution Act*, the support and co-operation of the Province of British Columbia (B.C.) and municipalities are prerequisites for sustainability of the resource.

28.3 The Department's Habitat Policy (1986) promotes both sustainability and genetic diversity. The Policy balances proactive elements (land use planning, integrated resource management and development of guidelines) and reactive elements (project review/approval, compliance monitoring and enforcement). The Department has tended to focus more on the reactive elements, but without sufficient emphasis on monitoring and follow-up.

28.4 Habitat management requires improved co-ordination within the Department and the increased involvement of external groups, including provincial and municipal governments, stakeholders and the public, under agreements that include accountability provisions, where appropriate. The Department's overall responsibility for habitat requires clear accountability to maintain control of the process and depends especially on B.C. being held accountable for its own habitat responsibilities.

28.5 The opportunity now exists for Fisheries and Oceans to further develop and strengthen its relationship with the Province following the signing in April 1997 of the new Canada-B.C. Agreement on the Management of Pacific Salmon Fishery Issues. The Agreement is intended to revisit existing areas of intergovernmental co-ordination covered under the 1985 General Fisheries Agreement and to examine other areas for co-operation. B.C. has released a discussion paper in anticipation of future negotiations. The Department's position on habitat management is expected to be clarified to prepare it for these negotiations.

Industry Canada

Management of the Small Business Loans Program

Assistant Auditor General: Richard Flageole

Responsible Auditor: Harry A. Ruthnum

Chapter 29 - Main Points

29.1 Small businesses play a very important role in our economy. In 1994, more than 98 percent of all businesses in Canada were small businesses with fewer than 50 employees. In 1995, small businesses contributed 43 percent of Canada's private sector economic output. However, the lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.

29.2 The objective of the Small Business Loans Program is to increase the availability of loans for establishing, expanding, modernizing and improving small business enterprises. New lending under the Program will end on 31 March 1998 unless the government decides to renew it. This presents an opportunity to better define the results expected from the Program and to improve performance measurement. As part of the decision to renew the Program, it will be important to take into account the needs of small businesses in a changing Canadian economy and business environment. The dual objectives of increasing the availability of loans at reasonable rates while recovering all the costs need careful analysis.

29.3 The Small Business Loans Program will incur a net loss estimated at \$210 million for loans issued between 1993 and 1995. The Program is now moving toward full cost recovery; however, under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved. Careful monitoring and better systems to forecast the future performance of the Program are needed.

29.4 Industry Canada requires lenders to comply with the *Small Business Loans Act* and Regulations and to exercise due care when making loans. The Department needs to strengthen its claim audit procedures to obtain assurance of such compliance. It also needs to take steps to minimize the interest it is paying on claims submitted by lenders. The intent of the Act regarding lending to related borrowers requires clarification.

29.5 It is important that the Department provide Parliament with the information necessary to assess whether the Program is managed efficiently and is achieving its objectives. In addition, more rigor is needed in evaluating the Program's impact on job creation.

Office of the Superintendent of Financial Institutions — Insurance and Pensions

Assistant Auditor General: Ron Thompson

Responsible Auditor: Crystal Pace

Chapter 30 - Main Points

30.1 Since 1987, when the Office of the Superintendent of Financial Institutions (OSFI) was established, the financial services industry has become much more integrated. The legislative framework has developed from a highly prescriptive system to one relying heavily on good corporate governance to ensure that depositors, policyholders and pension plan members are protected, without unduly restricting the competitive ability of Canadian financial institutions. Legislators have recognized that although regulation and supervision can reduce the risk that financial institutions will fail, some may fail nonetheless. OSFI has made significant progress in developing regulatory tools to meet its objectives, in response to the changing nature of the industry and the legislative framework. Although OSFI meets the needs of today's environment, it nevertheless needs to address important gaps that could affect its ability to meet its objectives in the future.

30.2 A key to success for OSFI is having the right people with the right competencies and using them effectively. OSFI has the basic human resource management systems in place and operating, and is moving forward on a variety of fronts. However, at this point it does not have some important information that it needs to estimate the degree to which activities planned or under way will help it achieve its objectives. It needs to have a more strategic approach to human resource management and a more rigorous analysis of issues to ensure that current and planned activities will help it meet its goals and objectives.

30.3 Overall, we found that OSFI is highly regarded by the insurance industry and by provincial and foreign regulators. It has developed some key aspects of its risk assessment and risk management framework -- standards for sound business and financial practices, and guides to intervention. However, they are not yet complete. We identified gaps in the implementation of the framework that could prevent OSFI from meeting its objectives in the future. For example, it needs to apply its risk ratings more rigorously; focus its life insurance examinations on key risks; and improve the integration of its analysts, examiners and actuaries. In addition, communication and co-ordination with regulated entities and other regulators need to be improved.

30.4 The supervision of pension plans at the federal level is in a state of transition. OSFI has recognized the need for a new regulatory framework that includes a new mandate focussed on protecting plan members, greater powers to intervene when plans are in difficulty, and formalized procedures for risk assessment. OSFI plans to establish a *Guide to Intervention* and *Standards for Sound Governance and Financial Practices* for pension plans.

Revenue Canada

The Financial Management Regime

Assistant Auditor General: Shahid Minto
Responsible Auditor: Basia Ruta

Chapter 31 - Main Points

31.1 Revenue Canada's 40,000 employees dispersed across 800 offices collect about \$850 million and disburse some \$425 million on average each working day.

31.2 The sheer size of Revenue Canada, the importance of its contribution to sustaining other government programs and its high visibility to taxpayers require a strong commitment to effective financial management. In the aspects of financial management examined during our audit, we found some areas of strength and no areas of neglect. We also noted several areas in need of improvement. Revenue Canada has gone through a period of tremendous change, both organizational and legislative. It is now at a stage of maturity where it needs to give more attention and a higher priority to financial management.

31.3 The Department has been proactive at establishing corporate plans and strategic documents that are linked to government objectives and priorities. Management agreements are being used to help promote a common vision and strengthen managers' accountability.

31.4 Revenue Canada's performance in the prompt deposit of billions of dollars of payments it receives from taxpayers at its offices and ports is generally satisfactory. Our tests show that the vast majority of taxpayer remittances are deposited by the next business day. Still, opportunities exist to improve departmental performance in this area and generate several millions in potential interest revenue for the government each year.

31.5 Revenue Canada's practices in the monthly reporting of revenues require more rigour. Basic accounting systems in support of \$18 billion in annual deposits by Customs need to be modernized considerably.

31.6 Deficiencies exist in other formal systems and practices pertaining to key areas of financial management. Informal information systems, proxy measures or other mechanisms are being used in an effort to bridge those deficiencies. Some of the shortcomings have a multiplier effect on financial risks to the public purse, and impact on other federal-provincial programs whose benefits or credits are tied to information contained in Revenue Canada's systems. Departmental initiatives are either planned or under way to address some shortcomings.

31.7 We have significant ongoing concerns about the reliability of information meant for use in monitoring and analyzing program statistics, trends and performance. As Revenue Canada becomes increasingly reliant on using information in diverse ways to monitor and support its programs, there is a crucial need to clean and purify data to remove any inaccuracies and ensure that they are in an appropriate form for analysis.

31.8 Although responsibility for financial management is shared and decentralized among headquarters, program and regional operations, Revenue Canada does not review or co-ordinate systems and practices

Department-wide. Nor has internal audit been used effectively to provide independent overall assurance on the state of financial management and control across the Department.

Revenue Canada and Department of Finance

Understanding Changes in Tax Revenues: GST

Assistant Auditor General: Shahid Minto
Responsible Auditors: Scott Milne and Jim Ralston

Chapter 32 - Main Points

32.1 Chapter 31 of this Report highlights the importance of appropriate, sufficient and timely analyses to understand fluctuations in various revenue streams. Good analyses can improve the government's ability to identify errors, increase the government's awareness of new economic trends, enhance the credibility of the financial information reported to Parliament, and improve the accuracy of the government's forecasts of tax revenues, deficits and net borrowing needs. Good analysis of revenue movements also supports Revenue Canada's programs and initiatives to identify tax avoidance techniques being used by registrants or to note changes in registrant compliance.

32.2 In this chapter, we consider what would constitute an appropriate process for analyzing movements in revenue streams, the minimum extent to which the process should be followed, and the factors that hamper the attempts of Revenue Canada and the Department of Finance to understand changes in tax revenues. To do so we selected, as an example, the \$400 million decrease in net Goods and Services Tax (GST) that occurred from 1994-95 to 1995-96 (from \$16.8 billion to \$16.4 billion), and reviewed the departments' attempts to analyze it.

32.3 Both Revenue Canada and Finance are satisfied that the amount of effort they devoted to finding an explanation for the decrease in net GST was appropriate given the size of the decrease and the nature of the available information. However, no conclusive explanation for the decrease has been found.

32.4 We believe that Revenue Canada and Finance followed an appropriate analytical process to a certain extent. We believe, however, that the process needs to be followed more fully. As a minimum, the departments need to adjust for bookkeeping errors and distortions caused by the cash basis of accounting before assessing the extent to which further analyses are required. If the need for further analysis is revealed, the departments could consider additional factors related to changes in the economy and in registrant behaviour to obtain a more robust explanation of changes in GST revenue.

32.5 Although the departments made attempts at analyzing the decrease in GST revenue, problems with the reliability and timely accessibility of some of the data, as well as the lack of other data, inhibited their efforts. Ensuring the reliability and timeliness of the data, and making more use of available and reliable data, would improve the departments' ability to conduct timely analyses. Collecting additional information from some or all registrants could improve the departments' analytical capabilities. The government will need to maintain a balance between its need for more information for analysis and compliance purposes and the increased burden it places on registrants to provide the information and on Revenue Canada to capture and store it.

32.6 Revenue Canada could improve its analytical capability by ensuring that a sufficient, proactive, timely and co-ordinated effort is mounted by the various units within the Department to analyze GST revenue.

The Correctional Investigator Canada

Assistant Auditor General: Maria Barrados

Responsible Auditor: Robert W. Chen

Chapter 33 - Main Points

33.1 The Office of the Correctional Investigator was first established in 1973 under the *Inquiry Act*, and formalized in 1992 under the *Corrections and Conditional Released Act* “to conduct investigations into the problems of offenders”. Although it is a small agency, the Office plays a very important role in ensuring fairness for those inmates serving sentences in Canada’s federal prisons. Its findings and recommendations can also help to improve systems and practices in Correctional Service Canada.

33.2 Over the years, the Office has accumulated a set of management practices. We found that while these practices are often helpful in resolving individual complaints, they are not conducive to efficient and consistent handling of cases and have contributed to the Office’s adversarial relationship with Correctional Service.

33.3 The Office needs to improve its operational strategies and management practices to reflect changes that have occurred in the correctional environment and in legislation since 1973. The Office needs to prioritize its activities on an informed basis in order to effectively manage its workload. It needs to establish policies and procedures to help its staff in investigating individual complaints. It also needs to improve the quality of its management information systems and provide better performance information in its annual reports.

33.4 Given the important role of the Office, improvements in its management are needed so it can better fulfil its mandate within the Canadian criminal justice system.

RCMP Public Complaints Commission

Assistant Auditor General: Maria Barrados

Responsible Auditor: Robert W. Chen

Chapter 34 - Main Points

34.1 The RCMP Public Complaints Commission is responsible for reviewing public complaints about the conduct of members of the RCMP. Although its budget is small (\$3.5 million), the Commission can, through its reviews, enhance the transparency of the complaint process and help the RCMP to improve its policing practices.

34.2 Although the Commission has articulated the need to develop and implement a communications strategy, it has yet to finalize its plan for informing Canadians about their right to request a review if they are not satisfied with the RCMP's disposition of their complaints.

34.3 The Commission's handling of complaint reviews and public hearings is slow. It needs to improve the way it works by streamlining the review process and providing appropriate training to Commission members who are responsible for conducting public hearings.

34.4 The Commission also needs to improve its performance measures. Although useful statistics are provided in its annual report, they are often incomplete or inconsistent. The Commission needs to renew its effort to provide a fuller picture that demonstrates both its contribution to the public complaints process and the overall effectiveness of that process.

Follow-up of Recommendations in Previous Reports

Chapter 35 - Main Points

35.1 Progress toward addressing our recommendations contained in previous reports is noted in each of the follow-up segments included in this chapter. However, in most cases, additional work is needed to deal with the recommendations satisfactorily. For example, Natural Resources Canada has taken steps in the right direction, such as the development of a policy framework for radioactive waste. However, much remains to be done to find long-term solutions for Canada's nuclear fuel waste, low-level radioactive wastes and uranium mine and mill tailings.

35.2 The following significant areas of concern remain:

- Five years after noting our concerns, much remains to be done to ensure that Canada is prepared for major oil and chemical spill emergencies.
- Parliament continues to need adequate information on the risks and clean-up costs of federal contaminated sites. While some progress has been made, environmental liabilities are likely quite substantial and could materially affect the government's reported financial condition.
- The issues reported in this chapter and in Other Audit Observations, Chapter 36, regarding on-reserve facilities funded by Indian and Northern Affairs Canada, continue to raise concerns about the Department's cost effectiveness in addressing on-reserve needs. These concerns involve deficiencies in project planning, implementation, evaluation and related matters.

35.3 In some cases, downsizing has resulted in many changes to programs delivered by federal government departments and agencies. We have noted several delays in addressing our recommendations as a result of program changes.

35.4 In two cases included in this chapter, the departments concerned performed studies or reviews in response to our recommendations, but corrective action is yet to be implemented.

35.5 We encourage departments and agencies to continue addressing our concerns through further corrective action.

Other Audit Observations

Chapter 36 - Main Points

36.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

36.2 The “Other Audit Observations” chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

36.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

36.4 Observations reported this year cover the following:

- information to Parliament on the use of “special measures” falls short of legislative requirements and Parliament’s needs;
- an initiative to provide spare parts failed to maximize its potential cost-saving benefits;
- escalating costs of a water supply project were not adequately justified;
- lack of compliance with a funding arrangement resulted in questionable costs;
- an \$801 million payment raises concerns over accountability requirements;
- the design and construction of a facility illustrates a “build [up] to budget” approach that does not encourage cost savings; and
- departmental standards and practices were not followed in awarding a duty free shop licence.

36.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Sustainable Development Strategy for the Office of the Auditor General

Deputy Auditor General: Michael J. McLaughlin

Responsible Auditor: Gisèle Grandbois

Chapter 37 - Main Points

37.1 This is the Office of the Auditor General's (OAG) first sustainable development strategy. It tells parliamentarians how we intend to integrate environmental and sustainable development considerations into our business as a legislative audit office, and how we will measure our success in doing so.

37.2 This Office has a long history of involvement in environmental and sustainable development issues. In particular, over the past decade it has been a leader in conducting audits related to the environment. The *Auditor General Act* was amended in December 1995 to formally incorporate environmental and sustainable development issues into our mandate. The Commissioner of the Environment and Sustainable Development was appointed by the Auditor General in 1996.

37.3 Our sustainable development strategy encompasses the three core dimensions of our activities: our audit operations, our day-to-day operations, and our human resources. The sustainable development goals for our audit work are to promote sustainable development by:

- providing advice and information to parliamentarians and members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work;
- supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations;
- providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada.

37.4 Another goal we have is to minimize the negative environmental impacts of our day-to-day operations. Finally, we wish to support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals.

37.5 Our strategy is action- and results-oriented: for each of our sustainable development objectives, we have identified the specific actions we need to take and have developed performance indicators that will help us monitor our progress toward achieving our goals and objectives.

37.6 The most pressing environmental and sustainable development issues facing government today cut across departmental mandates and political jurisdictions. Auditing these horizontal and cross-jurisdictional issues represents a challenge of integration and co-ordination for our audit teams as well as an opportunity to broaden our perspective.

37.7 Departmental sustainable development strategies represent a very important new tool for federal organizations. In addition to monitoring their progress, we will help strengthen the capacity of these organizations to build better strategies and implement them. Similarly, the petition process will create a more direct link with Canadian citizens wishing to express their concerns about the environment and sustainable development.

37.8 Globally, we believe we can make a difference in the quality of Canada's environment, and in its prospects for sustainable development.

Chapter 22

Crown Corporations: Making Performance Measurement Work

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Crown Corporations: Making Performance Measurement Work

Assistant Auditor General: John Wiersema

Responsible Auditors: Pierre Serré and Grant Wilson

Main Points

22.1 Management and boards of directors of Crown corporations, as well as government and Parliament, require performance information to determine the extent to which expected results have been achieved by Crown corporations. Performance measurement is central to good management and helps fulfil accountability requirements.

22.2 Some Crown corporations are further along than others in developing performance indicators, but the process is under way for all. The experience of those that have moved beyond theory to practical application will undoubtedly be of benefit to those wishing some guidance. We would expect that, if corporations use performance indicators to manage, this should lead to better performance reporting as well as fewer significant deficiencies in the third cycle of special examinations.

22.3 Leadership as well as clear objectives and strategies are essential to support the development of performance indicators by which to assess performance. These indicators can then be used throughout a corporation to align plans and activities with corporate objectives and public policy roles.

22.4 A corporation needs indicators that are complete and balanced to effectively support the alignment of plans and activities with objectives and roles. There are a number of frameworks that can assist a corporation to develop and maintain its set of indicators.

22.5 It is important that boards of directors of Crown corporations use performance indicators in monitoring and evaluating performance and require management to develop and use indicators as a meaningful and integral part of the management process.

22.6 Boards of directors may wish to consider delegating to the corporations' audit committees some responsibility for assessing the state of performance measurement and reporting.

Introduction

22.7 Management and boards of directors of Crown corporations, as well as government and Parliament, require performance information to determine the extent to which expected results have been achieved by Crown corporations. Continued efforts to improve measurement and reporting are needed to provide management with an effective tool to manage corporate resources and to achieve the corporate mandate. There is also a need to improve reporting to Parliament.

22.8 Meaningful performance information will assist boards of directors in carrying out their oversight responsibilities. And meaningful performance measurement requires that both management and boards of directors establish and use performance indicators as an integral part of the management and governance of Crown corporations.

22.9 In 1984 when the *Financial Administration Act* was significantly amended, requirements for Crown corporation accountability and control were clarified, and roles and responsibilities of the board of directors in ensuring good management were set out. As part of this regime, Crown corporations are required to submit annually a corporate plan including goals, objectives and strategies for Governor in Council approval. As well, they are required to submit annual reports to Parliament, including statements on the extent to which objectives for the year have been met.

22.10 We have often commented on the state of performance measurement and reporting in federal Crown corporations — most recently, in Chapter 10 of our 1995 Report. That chapter reported, among other things, the results of our analysis of the second cycle of special examinations; these are a type of value-for-money audit of Crown corporations, the results of which are reported to boards of directors. One of our findings was that of the 80 percent of the corporations where one or more significant deficiencies were reported, each corporation had a significant deficiency related to either corporate and strategic planning or performance measurement and reporting, or both.

22.11 In 1996, we initiated research into performance measurement principles and practices and established a dialogue with federal Crown corporations on the subject, to increase their awareness of and focus on performance information. During our research into state-of-the-art practices in performance measurement, we concluded that it is important to develop a limited but complete set of key indicators that will assist management to manage. Consequently, our discussions with Crown corporations focussed on the use of performance information as a strategic management tool that would then act as a building block to improve governance and information to Parliament.

22.12 The government's recently launched initiatives for departments and agencies to renew the system for planning and managing expenditures and reporting on results confirm the growing interest in and importance of performance information. In chapters 5 and 11 of the 1997 Report of the Auditor General, respectively titled *Reporting Performance in the Expenditure Management System* and *Moving toward Managing for Results*, we outlined why we believe managing for results is an integral part of good management. Chapter 11, in particular, proposes a framework for managing for results as well as principles for moving toward managing for results.

Crown corporations continue to be an important government policy vehicle

22.13 Since 1993, when we reported extensively on the state of performance reporting by Crown corporations, assets administered by Crown corporations have remained large and fairly stable at approximately \$54 billion, whereas the related work force has decreased by one third. Additional information on the continued importance of this sector is presented in Exhibit 22.1. During the past few years, the most significant event was the privatization of

the Canadian National Railway Company and most of its wholly owned subsidiaries. In addition, Export Development Corporation, Farm Credit Corporation, Business Development Bank of Canada, Canada Deposit Insurance Corporation and Standards Council of Canada had their enabling legislation reviewed and modified, clarifying or expanding their mandates and powers.

Exhibit 22.1

Changes in Crown Corporations since 1993

	July 1993	August 1996
Number of parent (or acting) Crown corporations	48	46
Number of wholly owned subsidiaries	62	38
Number of employees	118,000	78,000
Total assets administered by Crown corporations*	\$53 billion	\$54 billion
Total long-term liabilities*	\$33 billion	\$36 billion

* excluding Bank of Canada

22.14 The level of interest in performance information in Crown corporations is growing steadily. Since the introduction three years ago of the Auditor General of Canada Award for Excellence in Annual Reporting by Crown Corporations, there has been an increase in requests from Crown corporations for guidance in helping them improve their reports. Although the awards focus on external reporting, they have increased interest among Crown corporations in using performance indicators for managing to improve results.

Nature of performance indicators

22.15 Measures can be categorized in a number of ways, but among those that have gained acceptance and credibility are those related to inputs, outputs and outcomes. Inputs are the amount of resources that are used or “consumed” by an activity or process. Outputs are the direct products and services produced by an activity or organization through its work processes. Outcomes can be classified as intermediate and ultimate. Intermediate outcomes reflect the direct effects from the outputs produced, such as a benefit for, change to or impact on a client group. Ultimate outcomes refer to the final impacts or broader consequences on the targeted group or society at large. While measures of inputs and outputs are useful, outcome measures have a greater significance in assessing the extent to which a corporation is meeting its mandate.

22.16 Measures of the relationship between inputs and outputs (efficiency) and between inputs and outcomes (cost effectiveness) also provide useful management information. In addition, explanatory information about the internal and external context that might affect a corporation’s performance, such as demographics, staffing and economic trends, is considered essential to complete the performance picture.

Focus of the study

22.17 The objective of this study was to encourage further development and greater use of meaningful performance measurement and reporting in Crown corporations. We provide specific suggestions and illustrative examples by highlighting important conclusions from our research as well as from our discussions with Crown corporations. We expect that improvements in this area will result in fewer significant deficiencies being reported in the third cycle of special examinations, as well as an increase in the use of performance information in the management and governance regimes of Crown corporations.

22.18 In this chapter, we also summarize our work in this area for Parliament. We emphasize the importance of performance information for effective management of Crown corporations and good governance. Among other things, the chapter describes the nature of performance indicators, their qualities and attributes and, consequently, what Parliament should expect from Crown corporations. Further details on the study objective, scope and approach are found at the end of the chapter in the section **About the Study**.

Study Findings

22.19 Crown corporations exist to serve public policy purposes. Our discussions with Crown corporations focussed on the measurement of success in fulfilling their public policy roles. The measurement of success must include the measurement of public policy results as well as other aspects of a corporation's business required to achieve success and maintain it. It is important that the Crown corporations focus not only on achieving objectives in the short term but also on "sustainable achievement". This requires a set of key indicators that provides insight into the future success of the corporation and facilitates managing.

22.20 Ideally, a Crown corporation would have within its management practices and tools a set of key indicators that are linked to its mandate, objectives and strategies. These indicators would be widely communicated and cascaded throughout the corporation to the level of the employee. Corporate performance would be assessed on the basis of these key indicators, and compared not only against internal plans and targets but also against other organizations by such processes as benchmarking.

22.21 The development of performance indicators in individual federal Crown corporations is currently at various stages of application. Some Crown corporations are using sets of key indicators that are largely linked to their strategic directions, although primarily at the corporate level. Their indicators are cascaded to some but not all levels throughout the corporation and performance is assessed mainly against internal plans, with limited outside comparison. Many corporations are in the process of developing sets of indicators, some are considering how performance measurement can be effectively implemented, while still others are in the early stages of implementation.

Clear Objectives and Leadership Support Are Prerequisites

22.22 Crown corporations have indicated that the following two conditions should ideally be present prior to embarking on an initiative to successfully identify a set of key indicators useful for managing:

- **Clear objectives and strategies.** Without clear corporate objectives and strategies (derived from and dependent upon the Crown corporation's legislative mandate and public policy role), it is very difficult to develop meaningful measures. Without knowing what results are expected and how to achieve them, it is difficult to manage for those results.
- **Leadership support and endorsement.** The support of the board of directors, the Chief Executive Officer and the senior management team is crucial to the success of performance measurement initiatives. Leadership support will foster the right organizational climate to support the use of performance indicators for managing.

22.23 The importance of clear objectives and strategies was noted by one Crown corporation during an early attempt to initiate a performance measurement system. After reviewing the feasibility of the project, the responsible manager returned to the Chief Executive Officer (CEO) and indicated that the corporation was not ready, as it had not enunciated a clear strategic direction. The CEO accepted the feasibility report's conclusion and delayed the project until the objectives and strategies had been clarified. However, corporations do have differing situations and, even though the objectives and strategies may need clarification, a corporation may wish to consider advancing its

use of performance indicators. In this way, the process of developing performance indicators could act as a catalyst to clarify objectives and strategies.

Performance Indicators Need to Be Complete and Balanced

22.24 If performance indicators are to be used to assist in managing a corporation, then what gets measured must be determined carefully. It is important that a set of measures contain a limited number of indicators (perhaps no more than 12 to 15 at the corporate-wide level), while also being representative of the key aspects of the corporation. A corporation needs to measure, in addition to public policy achievements, those key aspects of its business that will lead it to success. In other words, completeness of the indicators depends on measuring all of the key success factors of a corporation. An incomplete or biased set of key indicators can lead to unintended behaviours and, consequently, unintended outcomes. Accordingly, the assessment of the achievement of stated objectives may be severely hampered by an incomplete set of key indicators.

22.25 In addition to completeness, we found that the usefulness of a set of key indicators is greatly enhanced if there is a certain balance inherent in it. A corporation needs to ensure that there is a balance of input, output, outcome and efficiency indicators supported by explanatory factors. Balance also refers to the “push-pull” conflicts such as long-term versus short-term, leading versus lagging and financial versus non-financial indicators. In addition, balance addresses the distortion that may result from emphasizing certain key success factors over others.

22.26 In our research and discussions with Crown corporations, we found certain key recurring areas that need to be measured. These include public policy results, client focus, human resources, financial results, internal processes, and environmental management. The extent to which each of these applies to a particular corporation depends on the corporation’s operations and circumstances. In addition, we found that there are interdependencies among the areas being measured, in that the results achieved in each area can affect the results achieved in other areas.

22.27 Public policy. One element that is particularly important for Crown corporations to measure is related to the public policy role for which each corporation has been established. Measurement of this element should reflect the very reason for the creation and continued existence of the Crown corporation; as such, the unique measures are often the most difficult to develop.

22.28 Client focus. Crown corporations need to ensure that there is an adequate coverage of customer-oriented, results-based indicators. Product or service relevance and acceptance are important aspects of client focus. Indicators in this area are most useful if they can assist the corporation in learning from its customers, clients or stakeholders. Customer satisfaction, market share, and customer retention are examples of indicators used in this area.

22.29 Human resources. This area addresses how well a corporation is able to manage its human resources. It refers to the extent to which personnel are able to realize their full potential, while supporting the corporation’s objectives and strategies. Corporate infrastructure, including the administrative processes and information systems, often has a great influence on how employees are supported in, or prevented from, demonstrating their capabilities. Employee commitment, motivation and development are also important facets of this area. Employee turnover, the ratio of computers to employees, employee training dollars or hours, and other indicators often arising from employee surveys are examples of indicators used in this area.

22.30 Financial results. A corporation needs to measure its financial health. It is the state of a corporation’s financial health that enables it to provide products and services to clients, customers or stakeholders. Net income, return on equity and return on assets are examples of indicators used in this area. Some corporations may also measure the extent of reliance on government funding.

22.31 Internal processes. A corporation also needs to measure the critical business processes that deliver its products or services, while adding value to its clients, its customers or stakeholders. Efficiency, productivity and responsiveness figure prominently in this area. Cost per unit (of output and/or outcome), time to market, and response time are examples of indicators used in this area.

22.32 Environmental management. The environment plays an increasingly important role in the public's perception of good government. This is not unique to government but government activities are held by the public to a very high standard of environmental performance. Consequently, this area may require a greater corporate focus through the development of related indicators. These could be derived from a sustainable development strategy or other practices used by many private sector organizations for reporting on environmental performance.

22.33 Other areas. Performance indicators may also be required in areas such as leadership, strategic planning, supplier focus and planning for improvement. A common thread is the clear focus of all activities toward the achievement of a corporation's goals and objectives. This provides for an alignment of effort in the corporation that promotes efficiency, as only activities that will lead to the achievement of goals and objectives are considered worthwhile to undertake. The choice of individual indicators within key areas, such as the ones presented above, also depends on a corporation's external and internal context. Employee turnover, for example, may be a useful measure in one corporation while providing little or no value in another.

22.34 We have found that Crown corporations use frameworks to assist in the development and maintenance of a balanced and complete set of indicators. A corporation may choose from a number of frameworks, and may choose elements from different frameworks or add elements to a framework. Some of the frameworks encountered in our research include the Kaplan and Norton Balanced Scorecard, awards criteria such as the Canada Awards for Excellence and the Malcolm Baldrige National Quality Award, as well as quality initiative elements, including those promulgated by the International Organization for Standardization (ISO). In addition, the CCAF (formerly called the Canadian Comprehensive Auditing Foundation) has a framework for governance information for boards of directors, while the Canadian Institute of Chartered Accountants (CICA) has issued a criteria of control framework (CoCo). The ultimate objective for each Crown corporation is to develop a complete and balanced set of key indicators for managing, not necessarily to follow a particular model or framework.

22.35 Attributes of good performance indicators. While sets of indicators need to be complete and balanced, indicators themselves require certain qualities to be useful. Exhibit 22.2 sets out a list of attributes of good performance indicators. These attributes contribute to the ability of an indicator to support management in managing the corporation.

Exhibit 22.2

Attributes of Good Performance Indicators

A good performance indicator is meaningful (understandable relevant comparable) reliable and practical .	
Attributes	Explanation
Meaningful <i>understandable</i>	<ul style="list-style-type: none"> • clear (clearly and consistently defined) • context (explained) • concrete (measurable) • lack of ambiguity in direction
<i>relevant</i>	<ul style="list-style-type: none"> • relates to objectives • significant and useful to the users • attributable to activities
<i>comparable</i>	<ul style="list-style-type: none"> • allows comparison over time or with other organizations, activities or standards

Reliable	<ul style="list-style-type: none"> • accurately represents what is being measured (valid, free from bias) • data required can be replicated (verifiable) • data and analysis are free from error • not susceptible to manipulation • balances (complements) other indicators
Practical	<ul style="list-style-type: none"> • feasible financially • feasible to get timely data

22.36 Sets of indicators are dynamic. The components of a complete set of indicators used to manage are subject to change over time. This is not to say that indicators that highlight “bad news” need to be removed from the set of indicators but that the indicators must reflect the evolving directions and context (internal and external) of the corporation. An indicator may lose its usefulness over time due to changes in the corporation’s mandate, strategies or objectives. However, the decision to add or drop an indicator is not one to be taken lightly and depends on each corporation’s circumstances.

The Implementation Process Is As Important As the Indicators

22.37 The following are illustrations of Crown corporation experiences that reflect some common and important considerations involved in developing performance indicators.

The process varies among corporations

22.38 Corporations that have decided to use performance indicators in a comprehensive manner to assist in managing generally follow the steps set out in Exhibit 22.3 to establish an initial set of key indicators prior to using them. While the steps have a logical progression, our discussions with Crown corporations indicated that the sequence may vary. Some steps are initiated prior to others that appear earlier in the sequence, and some steps are carried out simultaneously. In addition, once an initial set has been identified, the issue of integrating the indicators into the management process, which includes the maintenance of the set of selected key indicators and their targets, must be addressed. The development of a complete and balanced set of key indicators is an iterative process that can extend well beyond a year.

22.39 One Crown corporation indicated that the steps for implementation generally follow its corporate planning process and, accordingly, suggested that it may be appropriate to look at those external factors that may have a significant impact on the corporation. It believes that a corporation needs a consensus on these factors in order to focus corporate directions and objectives properly. It also believes that the steps outlined in Exhibit 22.3 should be undertaken annually. Another Crown corporation indicated that when indicators are documented and reported, people start getting focussed.

Exhibit 22.3

Steps for Developing an Initial Set of Key Performance Indicators

- Clarify corporate objectives by reference to mandate, including the public policy role, and build a consensus throughout the corporation on the corporate direction and expected results (this may include customer and other stakeholder consultation).
- Identify and clearly define the critical success factors to meet the already established corporate objectives, as well as the key corporate activities required to support the critical success factors (a completeness framework may prove useful at this stage).
- Identify potential high-level key indicators.

- Establish performance targets.
- Define and validate indicators, including identification of data-gathering mechanisms.
- Select the complete set of key corporate indicators.
- Cascade measures throughout the corporation.

22.40 One Crown corporation expressed that the exercise was key to ingraining performance measurement concepts into people's behaviour and emphasizing the importance of measurement. Another Crown corporation claimed that there is no "recipe for success". The process of developing and choosing the right critical success factors and performance indicators is unique to each corporation.

22.41 One Crown corporation found that going through the process of developing performance indicators had an unexpected impact on operations and activities. In trying to identify indicators of the adequacy of its collection, the corporation realized that it did not have a clear understanding of what would constitute an adequate collection. Consequently, it initiated additional research into the nature and size of its desired collection. This operational change also allowed the corporation to identify surplus items and to develop an action plan for dealing with surplus items and acquiring new ones.

Communication, reporting and regular management reviews are essential

22.42 Crown corporations emphasize that communication remains important, both for communicating the initiation of an exercise to develop performance indicators and for communicating results. The latter function provides the opportunity for feedback throughout the corporation, which reinforces the link of activities to corporate strategies and objectives.

22.43 Performance indicators can also be useful in sensitizing managers about the importance of and the need for high performance levels, setting standards and benchmarks, and motivating staff. They can also play a key role in making the corporate strategic plan operational.

22.44 There is a need for regular management review of the information provided by the performance indicators. Without that review, and actions resulting from the review, people in the corporation will not perceive that the indicators are important and may lose focus on achieving goals and objectives.

22.45 One Crown corporation found the inclusion of performance indicators in the corporate plan to be useful, particularly when the plan is widely disseminated throughout the corporation. This promotes a greater understanding among all employees of the corporation's objectives and strategies and how progress will be measured.

Performance indicators can be used to allocate scarce resources

22.46 One Crown corporation indicated that a significant breakthrough for it occurred when it distinguished between those indicators that are merely "useful statistics" and those that can be used for resource allocation. If the corporation is not willing to reallocate resources when an indicator suggests that a target may not be met, then there is a good chance that the performance indicator is not useful. Alternatively, this may suggest that management is not committed to using the indicator or that the objective linked to the performance indicator is not taken seriously by management, implying that it is not a relevant corporate objective. This underscores the requirement for a well-developed and accepted set of corporate objectives.

Performance indicators can be a catalyst for synergies

22.47 One Crown corporation found that the development and selection of corporate level performance indicators helped to break down organizational “stovepipes”. The effect of organizational stovepipes may be seen, for example, when each area head prepares a portion of the corporate plan, and these separately developed plans are then brought together to form the corporation’s annual or five-year plan. This may result in a lack of synergy or integration of effort. Since each area usually has some impact on other corporate areas, the development of corporate-wide objectives supported by indicators has been found to be useful in breaking down these stovepipe barriers. The corporation found that asking each area what and how it can contribute to the accomplishment of corporate goals, coupled with providing everyone with a greater awareness of the interdependencies in the corporation, focussed management effort.

Cascading of performance indicators throughout the corporation is necessary

22.48 Cascading of indicators is a process whereby each successive level (region, branch, unit, sub-unit or individual) is asked to respond in a concrete and measurable fashion to questions asking how its activities will contribute to the achievement of the chosen strategic directions and outcomes stated in the corporate plan. Cascading may require the establishment of different indicators at different levels throughout the corporation, each supporting corporate-wide performance indicators. Alternatively, a corporate-wide indicator may be found at each level. One Crown corporation used the following series of questions at all corporate levels to cascade its indicators throughout the corporation:

- What action(s) are going to be undertaken this year to contribute to the achievement of the corporate plan?
- What is the targeted outcome of the action(s)?
- How will achievement be measured?
- When will the result be achieved?
- What parameters must be put on this objective to ensure that its achievement does not negatively impact on other objectives?
- How will results be monitored?

Accountability for specific indicators needs to be assigned

22.49 One Crown corporation assigns accountability by identifying an “owner” for each indicator. This provides the owner of a particular indicator with the responsibility for taking action based on the information provided by the indicator. Should the required actions exceed the owner’s authority level, the owner brings the issue up to the next management level. This promotes a proactive form of management in which owners of indicators report not only on the trend of their assigned indicators but also on the actions taken or needed to ensure that targets are met.

Indicators must be defined and validated

22.50 The practice of users defining the indicators is based on the premise that the best indicators will be developed by the people who are actually involved in the activities being measured and that these people should also be the first users of the indicators. There is a need, however, to seek input from others, including customers and other stakeholders. In addition, one Crown corporation found that it is important for a central team to validate the

indicators with the originator. Validation means testing the results of the indicators as defined by the eventual users. It provides an opportunity for the originator to confirm that the information the indicator was designed to provide is actually provided. The experience of this Crown corporation suggests that as soon as the underlying data for an indicator are generated, the indicator should be validated by its owner.

22.51 One Crown corporation found that the indicators that were implemented first were the easiest ones to define and validate. Consequently, it noted that the more difficult indicators, and possibly the more important and useful ones, were not being pursued vigorously due to a false sense of accomplishment. This demonstrates that there is a need to validate all indicators.

22.52 Defining an indicator may appear to be a relatively simple exercise but is actually a time-consuming and necessary step in developing a complete set of performance indicators. Key items usually defined for each indicator are listed in Exhibit 22.4.

Exhibit 22.4

Performance Indicator Definition Checklist

<ul style="list-style-type: none"> name of indicator (how this indicator will be commonly referred to in the corporation) 	<ul style="list-style-type: none"> frequency of data collection (monthly, weekly, quarterly, etc.)
<ul style="list-style-type: none"> reference to critical success factor and/or strategy (which strategic direction the indicator supports) 	<ul style="list-style-type: none"> target (one year, five year, longer term)
<ul style="list-style-type: none"> technical definition (specifically how each data component produces the final indicator number) 	<ul style="list-style-type: none"> links to other indicators (documents the interrelationship among indicators)
<ul style="list-style-type: none"> data source(s), availability and reliability (this will entail information systems considerations) 	<ul style="list-style-type: none"> cost of gathering data (how much it costs the corporation to gather or obtain the data)
<ul style="list-style-type: none"> owner (decision-making responsibility and data-gathering responsibility) 	<ul style="list-style-type: none"> significance (the implication if the indicator increases or decreases)
<ul style="list-style-type: none"> current indicator reading (if information available) 	<ul style="list-style-type: none"> other pertinent information

Influence, not manipulation, is needed

22.53 Closely related to defining and validating indicators is the influence of corporate and individual activities on the indicators. It is essential that these activities have a certain degree of influence on the results being measured. Without a cause-and-effect relationship, the usefulness of the activity as well as the appropriateness of the related indicators may be questioned, resulting in a lack of management focus.

22.54 It is important that the degree of influence on an indicator not extend to manipulation of the results. For example, one Crown corporation considered the number of artifacts in an exhibit as a potential indicator of the effective use of a collection. However, it concluded that this indicator could be manipulated by simply choosing smaller artifacts from the collection. The impact of such actions was not viewed as consistent with or supportive of corporate directions, and consequently the indicator was rejected.

Indicators for Managing Will Enhance Performance Reporting

22.55 Chapter 4 of our 1993 Report addressed the issue of performance reporting in Crown corporations. The 1984 amendments to the *Financial Administration Act* incorporated, among other things, the following principles:

- Parliament will be informed of the objectives and strategies of Crown corporations as approved by

government; and

- Parliament will receive a systematic flow of timely, pertinent information on actual performance so that it can judge how well Crown corporations have achieved their stated objectives for each planning period.

22.56 The practice of reporting against established objectives is basic to good management. In fact, Part X of the *Financial Administration Act* places considerable emphasis on performance reporting:

- Corporations must state in their corporate plan summaries their objectives, strategies and expected performance for the year.
- Corporations must disclose in their annual report the extent to which objectives have been achieved.
- The Treasury Board has the power to require that certain quantitative performance information be included in annual reports.
- The Treasury Board has the power to call for the audit of quantitative performance information in annual reports.

22.57 As part of the process for the Auditor General Award for Excellence in Annual Reporting, we reviewed recently published annual reports and corporate plan summaries. Although there is still much to be done in this area, we found that most Crown corporations had reported some information in three areas: financial performance, public policy and internal processes. Almost all corporations report two or more financial indicators, while most report at least one public policy outcome indicator and one internal process indicator. Examples of financial indicators most often used include net income and the percentage of non-governmental sources of funding. Public policy indicators are specific to each corporation. Examples of internal process indicators that have been reported include administrative expenses as a percentage of total costs, and marketing costs as a percentage of revenue. Less than half of the reports we reviewed had customer indicators and only a few had human resource indicators or any reporting on environmental practices.

22.58 We have previously reported that improvement in performance reporting by Crown corporations is required. We believe that once management develops and uses indicators to assist in effective management, the building blocks for effective performance reporting will exist.

Conclusion

22.59 The importance of performance information as a tool for reporting as well as for managing corporations is clear. Complete and balanced sets of key performance indicators provide useful information with which to improve operations, integrate day-to-day activities with strategic plans, monitor and evaluate performance at all levels and confirm the validity of past strategic decisions.

22.60 Performance information is a powerful tool but it cannot by itself make the corporation succeed. Management must still identify, choose and act on strategic initiatives and directions. Performance indicators can then help measure how the strategies and actions have influenced the success of the corporation, and can provide valuable input to the decision-making process. Performance measurement is not a substitute for leadership or a compensating factor for poor strategies or a lack of core competencies.

22.61 Boards of directors need to use performance indicators in monitoring and evaluating performance, and to require that management develop and use performance indicators as a meaningful and integral part of the

management process. They may wish to consider delegating to the corporations' audit committees some responsibility for assessing the state of performance measurement and reporting.

22.62 Government and Parliament need to continue to emphasize the importance of performance indicators in their review of Crown corporation annual reports and corporate plan summaries.

About the Study

Objective

The objective of this study was to encourage further development and greater use of meaningful performance measurement and reporting in Crown corporations. We provide specific suggestions and illustrative examples by highlighting important conclusions from our research as well as from our discussions with Crown corporations. The chapter also reinforces the need for Crown corporations to set clear and measurable strategies, goals and objectives — the foundation of good performance measurement.

We expect that if corporations use performance measurement to assist in managing, then in the future we will see fewer significant deficiencies being reported in special examinations of Crown corporations and better information on performance reported to boards of directors, government and Parliament.

Scope and Approach

Largely as a result of our findings from the second cycle of special examinations, we undertook to research issues related to performance measurement. Our research started with a review of existing practices and developments in performance measurement in both the public and private sectors. One of the key activities involved dialogues with 23 federal Crown corporations to understand how performance measurement concepts and practices were being used and how issues were being addressed. We carried out in-depth discussions with 10 of those corporations, which represent approximately \$19 billion of assets and 16,000 employees. In addition, as part of the process for the Auditor General Award for Excellence in Annual Reporting by Crown Corporations, we reviewed performance information reported in all Crown corporation annual reports and corporate plan summaries.

Study Team

For information, please contact Pierre Serré or Grant Wilson, the responsible auditors.

Chapter 23

Systems under Development: Taking Charge

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Systems under Development: Taking Charge

Assistant Auditor General: Doug Timmins

Responsible Auditor: Eric Anttila

Main Points

23.1 In its efforts to respond to perceived needs of taxpayers and to reduce its costs, the government has undertaken to develop many new information systems. In this audit, we examined three projects that were managed in-house by the departments. We found that they shared similar risks with contract projects, including being late, going over budget and not meeting the needs of users.

23.2 Compared with contract projects, in-house projects were better aligned with the business objectives of the departments and were broken down into more manageable components. In addition, senior management was more involved, communications were more effective and the expertise and experience of the staff were better used.

23.3 Two of the three in-house systems that directly serve Canadians need to reflect a better understanding of who the clients are and what their needs are.

23.4 The disciplines of planning, oversight and quality assurance reduce the risks associated with the business and technical complexity of both contract and in-house projects. However, the three projects that we examined had some deficiencies in these areas.

23.5 A major concern we have reported before is the lack of recording and tracking of actual project costs. Without such tracking, projects can take longer, cost more and deliver less. Although one project was able to provide us with fairly complete estimates, none of the projects could provide precise actual costs. We estimate that each of the three projects we examined will cost the taxpayers between \$50 million and \$100 million.

Introduction

Focus of the audit

23.6 Our review of systems under development is a continuation of similar work done in the past two years. We have been assessing the quality of project management in systems development projects in order to identify lessons to be learned and pitfalls to be avoided. A common industry definition of projects is an endeavour, limited in time, to create or enhance a product or a service in a way that distinguishes it from existing ones. Projects are not limited to the introduction of new information technology but may be related to all kinds of human activities such as a change in organizational structure and customer service. A significant body of best practices has developed over the years and we draw from it to conduct our risk assessments.

23.7 This year, we focussed on information technology systems managed and developed by departmental staff, with assistance, when needed, provided by individual consultants. We refer to these development projects as “in-house” projects. Although we could not establish firm costs for the three projects we reviewed this year, the estimated cost of each is in the \$50 million to \$100 million range. In previous years, our focus was on projects that were larger in size, often costing in the hundreds of millions of dollars, with most of their development contracted out in large fixed-price contracts (referred to hereafter as “contract projects”). In this chapter, we also review the status of the eight other projects that we examined in previous years and draw some general conclusions on the major differences and similarities in risk profiles between in-house and contract projects.

23.8 Further details on the scope and approach of this year’s audit are included at the end of the chapter in the section **About the Audit**.

Recent systems under development events

23.9 In March 1997, the Standing Committee on Public Accounts held hearings on Chapter 24 of the Auditor General’s 1996 Report — Systems under Development: Getting Results. We recommended to the Committee that all departments produce action plans for the implementation of the Treasury Board’s Enhanced Framework for the Management of Information Technology Projects. In addition, we suggested to the Committee that the Treasury Board Secretariat was uniquely positioned to monitor systems under development projects that require Treasury Board approval, with the view of informing the Treasury Board ministers if projects were experiencing serious risks of failing to meet stated schedules, budgets or requirements.

23.10 Departments were directed by Treasury Board ministers in June 1996 to apply the Framework to existing projects, as applicable, and future information technology projects, and so attest when seeking Treasury Board project approvals. The Treasury Board Secretariat has advised us that actions are under way in all departments to implement the Framework. In addition, two departments have declared their intention to improve their software development processes up to level 2 of the Software Engineering Institute’s Capability Maturity Model (Exhibit 23.1). The model has five levels of increasingly effective management of software development processes, with level 5 being the optimal level. Additionally, in response to a direct request by the Public Accounts Committee, Transport Canada has declared that it would fully apply the Framework if it were to develop another major system.

Exhibit 23.1

The Capability Maturity Model (CMM)SM

In 1986, the U.S. Department of Defense funded the establishment of the Software Engineering Institute (SEI) at Carnegie Mellon University. The SEI has developed a Capability Maturity Model (CMM) that is now available to all institutions worldwide. The Model outlines how an organization can establish a step-by-step roadmap to implement a software development improvement program. It also

can be used to assess the capability level of an organization or lead to the certification of an organization by an accredited evaluation team.

The Model includes five levels of maturity that describe “the extent to which a specific process is explicitly defined, managed, measured, controlled and effective” (CMM, The Process Maturity Framework, 1993).

CMM is a service mark of Carnegie Mellon University.

For information on the CMM and its five levels of maturity, please visit the SEI web site at <http://www.sei.cmu.edu>.

23.11 We recommended in our November 1996 Report that departments prepare action plans for the implementation of the Framework. The Treasury Board Secretariat will assess the implementation of the Framework within departments against a series of four target plateaus beginning in March 1998 and continuing to 2002. The Chief Information Officer Branch of the Secretariat reports that it will conduct a review of the progress of the 20 largest departments toward the March 1998 plateau. Departments will be expected as part of this exercise to develop an improvement plan that focusses on the achievement of the goals at the next three plateaus.

Implications of increasing business and technical complexity

23.12 In all 11 projects that we have audited over the past several years, one of the major factors contributing to project risk was increasing business and technical complexity. In our opinion, risks associated with complexity can be effectively managed by breaking down the project into more manageable components and doing a better job of planning and overseeing projects.

23.13 Business complexity in government has increased in recent years because of massive budget cuts, downsizing (in some cases, without a corresponding reduction of program requirements), program changes, new legislation, mergers of departments and reorganizations. Because of the increasing need to process information rapidly and to meet the pressing information needs of both managers and clients, business processes have to be re-engineered to provide real-time and just-in-time information. Furthermore, as we reported in Chapter 12 of our October 1997 Report, Information Technology: Preparedness for the Year 2000, the pending situation, referred to as the Year 2000 problem, has added new business imperatives that put all other information technology projects at risk in the struggle for available resources.

23.14 The 1990s have seen an escalation in technological sophistication to address more complex business needs that go beyond the simple automation of manual processes. New systems are based on the integration of new business processes and the supporting technologies, such as client-server, on-line transactions, networks, the Internet and interfaces to many legacy systems. Finding and developing the technical and business talent to address this sophistication is a major risk factor in itself.

23.15 To meet these challenging requirements, information technology must become part of the business processes themselves. The projects that have the best chance of succeeding are the ones where the development teams can integrate business and technical expertise to create new ways of delivering products and services to clients. The challenge for development teams is to combine these two sets of expertise effectively.

Observations

Our Assessment of the Projects Reviewed

23.16 A brief summary of three in-house projects that we reviewed is included in Exhibit 23.2. At Revenue Canada, we reviewed the Standardized Accounting and Corporate Tax Redesign project (SA/T2). It is an ambitious

and complex project with aggressive target dates that create the risk of schedule slippage for the project. The Department has mitigated project risk by:

- closely aligning the objectives of the new system with Revenue Canada's overall objectives;
- obtaining ongoing involvement and support of senior management;
- extensively involving intended users of the planned system in development activities;
- conducting regular independent risk assessments;
- using standards consistently; and
- using overall management discipline.

However, more attention needs to be given to the tracking of task times at a level sufficient to offer precise monitoring of actual progress.

Exhibit 23.2

The Three In-house Information Technology Projects in Brief

The **Standardized Accounting and Corporate Tax System Redesign (SA / T2)** project at Revenue Canada was started in mid-1995 to streamline and integrate all the revenue programs administered by the Department, starting with the Corporate Tax System, which handles business tax returns. The SA project will extend into 2001 and has a total estimated cost of \$82 million over five years, including ongoing maintenance. The T2 redesign project is estimated at \$24 million over five years, including maintenance. These projects are being funded internally by the Department. During the audit, plans were for an April 1998 implementation. The new Corporate Tax System is now scheduled for a later implementation, possibly by the fall of 1998, due to unforeseen complexities in the business requirements.

Self-Serve Systems at Human Resources Development Canada comprise a group of 15 projects that share the same project manager and are all meant to provide clients with an improved self-serve capability. These development initiatives, most of which are in the area of employment insurance, were regrouped in 1995 to better co-ordinate the Department's efforts in the face of budget cuts and closure of many local offices. Our review looked at the risk associated with the projects taken together rather than with individual projects. We estimate these 15 projects to cost about \$50 million over five years. The projects are at various stages of development, and implementation of the 15 projects is planned for various dates over the next few years.

The **Strategis** project at Industry Canada was initiated in 1994. Strategis is an initiative designed to make strategic business information available to Canadian businesses over the Internet. Phase I of the system was implemented in March 1996 and has enjoyed increasing use. Phases II and III are meant to enhance the web site, offer more business partnerships and introduce electronic commerce as a means of conducting business with Industry Canada. Strategis is expected to have electronic commerce operating by December 1998. The success of the site is completely dependent on both the quality of the information content and on the technology used. Therefore, we used the Department's estimate of \$22 million that includes the time of content experts used in the preparation of the documents put on the web in Phase I. The Department has estimated a further \$44 million over the next two years to develop and maintain Phases II and III of Strategis.

23.17 At the time of the audit of the Self-Serve Systems group of projects at Human Resources Development Canada, the projects, as a group, were assessed at high risk of not meeting their goals. However, the Department mitigated this risk by scoping the projects so that financial risk was reduced greatly and so that projects could stand alone to reduce interdependencies between them and protect them from delays in other projects. Risk was also mitigated by piloting projects in the field. The projects had good alignment of their objectives with the strategic goals of the Department, had senior management support and involvement and made good use of in-house expertise. In line with best practices, there were also efforts to establish a better quality assurance function. However, in some or all of the self-serve projects, we noted deficiencies with the planning, standards, documentation, task management and management of change requests.

23.18 At Industry Canada, we examined Phases II and III of Strategis. As Strategis moves forward, we are concerned that the project may experience high risks of not meeting its schedule, cost and service objectives. With the expansion of scope and complexity of Strategis, the focus and alignment that was firmly established for Phase I is becoming diffuse, the management of Strategis is not sufficiently integrated with the business side of Industry Canada and the current project management structure may not be adequate to achieve best results. There are efforts under way to make Phase I and some elements of Phase II part of normal publishing operations. Senior management has asserted that Strategis is more than just a web site but an initiative to transform the Department by providing access to government information resources, business transactions and new means of consultation. However, the development of a large web publishing site is a relatively new activity for government and industry. The Department has not taken this opportunity to apply project management best practices to an initiative of this type.

23.19 In summary, we observed that, in terms of best practices, in-house projects:

- were well aligned with departmental objectives and received strong support from senior management;
- were broken down into manageable components;
- made good use of in-house resources; and
- had good communications between developers and internal clients.

However, we are concerned that all of these projects lack a properly established independent quality assurance function and do not track task time. Except for the SA/T2 project, all projects need to:

- apply a planning discipline that includes the precise definition of tasks over reasonable time frames;
- consult more systematically with intended clients;
- manage change requests; and
- implement a discipline relative to standards and documentation.

Planning Projects

23.20 Under planning, we considered the following key elements:

- Knowledge / Involvement of Clients
- Integrated Teams
- Business Case
- Project Charter
- Overall and Detailed Project Plans
- Quality Assurance Plan

Knowledge and involvement of clients is essential

23.21 Planning starts with a good knowledge of the clients and of their needs. A common characteristic of the three systems we reviewed this year is that all involve serving clients outside the departments concerned and establishing partnerships with the private sector, other departments or other governments. This puts an onus on the project managers to clearly identify whom they are servicing and to develop the means to engage in meaningful consultations with the target clientele. However, in two of the projects examined, the extent of the effort required was underestimated. And, in an environment where change is constant, we found that consultations were infrequent or not tied to the definition or adjustment of the requirements for the new service. There is a danger that, if consultations are not frequent and continuous, the project will encounter stiff resistance or apathy when completed.

23.22 At Revenue Canada, there were extensive consultations to set up the new Standardized Accounting and Corporate Tax Redesign project. The Department has found it necessary to continue these discussions even while the development of the system is well under way. Since the clients believed that the system would have a great impact, Revenue Canada responded by continuing to be open and straightforward about the costs and benefits. An important innovation is the establishment of a steering committee with provincial partner representation and decision-making authority to co-ordinate ongoing consultations on electronic filing of corporate tax returns and its implementation.

23.23 At Human Resources Development Canada, there was evidence of efforts to consolidate previous information on clients and obtain some additional information from some client groups or associations. There are also efforts to continue the consultation in the context of specific pilot projects. The Department has provided mechanisms to gather client comments through its kiosks. However, in the case of client groups who do not use kiosks, feedback is obtained by staff and manually input into an information gathering system.

23.24 At Industry Canada, the intensive consolidation of useful client data at the start of the project, as well as continuing discussions with business associations, has provided a means for keeping in touch with client needs. The Strategis web site also permits users to make comments via electronic mail. Industry Canada staff are able to view these comments at any time and respond to them. However, obtaining feedback from all intended clients and not only from those who have reached the site and care enough to respond is a challenge the Department continues to face. At the time of the audit, to identify the continually changing clientele and their needs, the Department relied mostly on attendance by Strategis staff at industry association meetings, gathering of client input at the many demonstrations of the web site and measuring activity on the Strategis web site.

Fully integrated development teams are necessary for buy-in and support of projects

23.25 While we would expect the business side of a department to take the lead in client consultation and in the early stages of planning, a real synergy must develop that includes the information technology (IT) analysts in a fully integrated team. At Revenue Canada, for example, the Standardized Accounting project team consists of business and IT analysts and managers who were collocated throughout the development of the first business case and the overview plan. A synergy developed that persisted even after the team had outgrown its space and had to be split between two separate buildings. This synergy is nurtured by the continuing active senior representation of the sponsoring business units on the project team.

23.26 At Industry Canada, the projects are definitely business-driven but the same level of integration of the project teams does not exist. For example, business sectors are quite autonomous and, in many cases, have their own IT staff to prepare their applications and databases for the web site. Our observation is that this makes it difficult for Strategis to be more than just a web site because it still lacks the full buy-in and support of the whole Department for centrally co-ordinated standards of quality that would help Strategis to be “an initiative of transformation” for Canadian businesses and for the Department itself.

23.27 At Human Resources Development Canada, business units drive all IT activity but systems development follows a more traditional model where there is an organizational separation between the developers and their clients. Requirements are handed over to IT staff and a working system is handed back later. Business people and IT staff do not work in integrated teams but rely instead on meetings and other consultations throughout.

Investment proposals and business cases need to be complete and up-to-date

23.28 Good knowledge and involvement of the clients together with an integrated team are prerequisites for good planning. As part of the planning exercise, the integrated team needs to prepare a detailed investment proposal or business case that is tightly aligned with the business goals of the organization. The business case provides senior managers and others with information about the costs, the benefits to the business, the return on investment, and the risks associated with a proposed system, so a “go/no-go” decision can be made.

23.29 Over the years, the Treasury Board Secretariat has published guidance on the preparation of business cases and cost/benefit analyses. Most recently, the requirement was reiterated in the Treasury Board’s Enhanced Framework of May 1996, and supported by a new guide, *Creating and Using a Business Case for IT Projects*, first issued in May 1995 and reissued in November 1996. The guide sets out in detail what constitutes a business case and deals with how to identify costs and benefits, prepare plans for the realization of these benefits, assess risks, analyze and present alternatives, and conduct reviews to confirm and update the business cases over the life of IT projects.

23.30 A critical requirement for business cases is that they be kept up-to-date. An update can be the basis for what the Enhanced Framework refers to as a “gate”, where a “go/no-go” decision is made on the next stage of the plan.

23.31 To help departments identify areas for improvement, we took advantage of this year’s audit to do a review of business cases prepared since the issuance of the new Treasury Board’s guidance on business cases. Although the three projects we looked at had prepared business cases and, in some manner, had updated them, we noted that many of the elements of the government direction were not being followed. The following matters would have needed to be addressed in order to bring these business cases in line with the new Treasury Board guidelines:

- All costs were not included in the business cases. In all cases, some categories of costs were not considered, for example, money invested prior to the creation of the business cases. In two cases, costs were estimated for development only and not for ongoing maintenance. This factor can have a significant impact on the investment decision and the potential return on investment to the government.
- In all cases, risk assessments — the forecast of potential problems in the successful development and implementation of the proposed systems — were not included with the business cases presented to senior management. At Revenue Canada, risks assessments were done shortly after the business cases were prepared.
- In all three cases, the analysis of proposed investments did not consider measures of financial return, such as return on investment or other investment criteria suggested by the Treasury Board Secretariat’s guide on business cases.
- The three business case reports were not complete as they did not present the information noted above; nor did they describe what alternatives to the suggested strategy were considered.

23.32 The issues we noted present risks to the government that large investment decisions may be made on the basis of incomplete or inaccurate estimates and other information, resulting in much lower returns than anticipated. Good decision making at the start of the project is dependent on accurate and complete information.

Project charters bring discipline to projects

23.33 In our review of planning in the three in-house projects, we found evidence of a good and effective practice — the creation of project charters. A project charter is a living document that lays out the project goals, the roles and responsibilities of each member of the team, and the interdependencies between projects and between tasks. Key project investment parameters are identified up front, along with key business and technical assumptions, deliverables, project stages and tasks, task estimates and assignments, and criteria for judging success. The project charter is updated at every major stage of the project.

23.34 Revenue Canada prepared charters for each major component of the SA/T2 project. Human Resources Development Canada has also adopted the practice but, at the time of the audit, had applied it to only 2 of the 15 projects that make up Self-Serve Systems.

23.35 Compared with contract projects, in-house projects tend to lack the same level of project management discipline as is specified in contracts. We see project charters as an important means of bringing elements of that discipline into projects managed in-house. Project charters effectively become internal contracts that guide project teams.

Project plans set detailed management and supervisory agendas

23.36 Project plans. The discipline of preparing the project charter facilitates the preparation of the project plan. Literature in the project management field is extensive, and it is possible to purchase good development and planning methodologies and numerous effective planning tools.

23.37 In reviewing the planning of in-house projects this year, we found that the best practice was at Revenue Canada. It developed a top-down overview plan and a series of detailed plans over reasonable time horizons that identified all key work packages or project segments. These work packages were further broken down into task level plans that covered periods of one to two weeks. Key interdependencies at all levels and critical path items were identified.

23.38 To validate this top-down plan, Revenue Canada followed with a bottom-up planning exercise that fully involved all people responsible for the tasks. The Department did a complete review of all plans at the task level to verify all the details and rebuild the plans. As part of the integrated teams, people from the business units were full participants in this validation exercise.

23.39 Task completion criteria. To be completely effective at the task level, project plans must identify completion events precisely enough to give a clear “yes/no” indication of satisfactory completion. This implies that quality standards have been set for each particular task. We would suggest that a task be considered not complete until it has passed its quality gate, at which point it would be considered fully complete. None of the projects examined this year defined their tasks to this level of detail.

23.40 Revision of plans. All elements of planning need to be considered living documents that must be re-examined and revised periodically as necessary. During these revisions, all parties have to be consulted, risks reassessed and planning assumptions re-established. With each major revision of the plan, the business case also has to be reviewed and gating decisions made.

23.41 The purpose of planning is to set the management and supervisory agendas in as much detail as possible to permit effective oversight and monitoring of task execution until the project is completed successfully.

Project Tracking and Oversight

Breakdown of tasks identifies deliverables and resources

23.42 Good plans create meaningful benchmarks that permit the measurement and tracking of progress. The appropriate breakdown of tasks over reasonable time frames establishes not only the deliverables to be produced but also the resources that will be required. As mentioned, the identification of the deliverables needs to define the quality standards that must be met before a task can be considered complete. The resource definition needs to be very explicit and, wherever possible, specify the individuals involved and all other resources that are needed to get the job done.

23.43 The very magnitude and complexity of technology and business projects today make it necessary for management to exercise proper oversight to achieve the intended results. The key outcome of oversight is the timely application of corrective action when behaviour or results deviate from plan. The in-house projects we looked at were careful to break down their system requirements into more manageable components. While this approach adds another level of complexity to the project and requires more oversight in the form of co-ordinating, reporting and communicating, it is still preferable to the mega-project approach. However, except for the SA/T2 project at Revenue Canada, none of the in-house projects reviewed had broken down their work packages into tasks small and detailed enough to serve as meaningful tools to monitor actual progress and take corrective action.

Objective assessment measures must complement subjective ones

23.44 As part of their oversight role, managers need to have objective measures of progress and performance in addition to their own subjective assessments. None of the projects we reviewed measured the time actually being spent to compare it with the time estimated in the master plan. We consider this a fundamental tool in project tracking and oversight. This measure is needed not only to give senior management advance warning about possible delays but also to provide important lessons learned to improve the estimation of time to complete tasks in the future.

23.45 None of the managers on the projects we reviewed had the information needed to determine the actual project task costs. In all three projects, human resource costs, which are always the largest component of actual project costs, are known only at the corporate level and cannot be broken down to project tasks. Two objectives of project oversight are to determine how much productive time has been devoted to specific project tasks and how much work has actually been performed against plan. This allows managers to predict how the rest of the plan will likely proceed and to take corrective action where appropriate.

23.46 Managers usually need several methods to measure performance and project status. As described earlier, in setting up the plan, there must be a very concentrated effort to make the tasks short (one to two weeks) and defined such that a tangible, measurable output is produced. Measuring the actual time spent on a project task gives the manager an estimate of progress made relative to the original estimate. A less reliable and even softer measure is subjective judgment, although this can be firmed up by peer reviews and quality control “walkthroughs”.

23.47 At Revenue Canada, there is no time measurement but management has compensated for this deficiency by defining tasks of a short duration with tangible outputs and scheduling peer-level task reviews. Management claims these reviews are thorough and timely enough to quickly expose the exact status of the tasks and to allow management to take corrective action.

23.48 At both Human Resources Development Canada and Industry Canada, progress is measured with subjective assessments and management reviews of these assessments. There is no time tracking or peer review to provide another more objective view of progress. In our opinion, while it is important to have the assessment and

review of experienced managers, this in itself is inadequate for oversight and tracking. By the time management finds out that a time estimate is incorrect, the deliverable date may have passed and, by the time a recovery plan is created, the whole project may be close to being over budget. This potential risk can be mitigated if project components are small enough, task durations are very short and management acts quickly and decisively to recover from an incorrect time estimate or a missed deadline.

23.49 Both Human Resources Development Canada and Industry Canada use a development technique where a series of gradually improved prototypes allow the business line people to validate requirements and to monitor certain tangible outputs of the process. Although we would commend this as a useful and effective technique for developing systems rapidly and keeping business people involved throughout the development process, we do not see it as taking the place of proper management oversight and tracking. We also have concerns that prototypes can give an illusion of true progress while the issues of security, reliability and the ability to easily change the size and configuration have not been fully addressed. In many cases, before these prototypes are rolled out as production systems, very fundamental reworking is necessary.

23.50 Ironically, the government does not always apply to itself the performance measures it demands from its contractors. When the government contracts out its systems development work, it always demands cost and schedule performance measures of the contractor. In the in-house projects we examined, we did not see a project where the government applies these same requirements to itself.

Quality Assurance

23.51 Quality assurance is often confused with quality control. Quality assurance refers to a function upon which management, the client and the project sponsor can rely to satisfy themselves that the desired quality is being achieved. It involves the validation of all the processes that will be used to achieve the desired results. Quality control is a function that monitors deliverables and verifies, at each step of the process, that the proper results are in fact being produced. Quality assurance staff help to establish the criteria that will be used to verify the results. Quality assurance uses the results of the quality control to evaluate and improve the processes that produce the deliverables, and, over time, to ensure that responsibility for quality becomes part of everybody's job.

Quality assurance needs to be an independent function

23.52 To be effective, quality assurance needs to be independent of development and operational management. It should have the authority to recommend and follow up on the changes required to the processes used by development and operational people. Having the quality assurance function report directly to a senior level of management gives it the required positional authority to ensure that needed changes are made. When senior management is perceived as supporting quality assurance, the buy-in of everyone involved in the project is more likely.

23.53 It is in the interests of the project sponsor, the project leader and management to strongly support the quality assurance function by means of an objective review that validates all the plans, standards and procedures applicable to the project. This will help to build confidence in project processes and results and increase the likelihood that the expectations of the clients and project sponsor will be met.

23.54 At Revenue Canada, there is no independent quality assurance function but quality control is addressed throughout. We are concerned that without a quality assurance function, the Department may not have the means to systematically assess and deal with the lessons learned from quality control.

23.55 At Industry Canada, no mechanism exists to ensure that the integration of the service with the content meets the expectations of clients, except for the feedback that the Department obtains from clients who choose to

use electronic mail. We feel that this is inadequate for a web site that is intended to be the single window for businesses to obtain strategic information and to transact with the government. An independent quality assurance function could help to ensure that the Department achieved the full synergistic effect of having its technology people working with its business information experts.

23.56 At Human Resources Development Canada, management has taken concrete steps to establish an independent quality assurance function. A director has been appointed to co-ordinate all quality control activities and to examine the Department's development processes to outline deficiencies related to the Enhanced Framework. This quality assurance function is in its early stages and it is too early to predict how effective it will be in the future. Because Human Resources Development has been given the mandate to be the single window for all Canadians into all government job search activities, management believes that a fully supported quality assurance function is necessary to provide all the Department's partners and clients with the assurance that their expectations of a high-quality product will be fully met.

Conclusion and Recommendations

23.57 Comparison of in-house and contract projects. In three years, we have reviewed eleven projects, including four in-house ones. (For a report card on the previous eight projects audited, see Exhibit 23.3.) Although it was not our intention to prepare a detailed comparison of in-house and contract projects, we have seen similarities and differences in risk profiles that allow us to draw general conclusions. Overall, we conclude that in both in-house and contract projects, practices would need to be improved to provide the assurance that projects will meet their clients' needs on time and on budget.

Exhibit 23.3

Report Card on Projects Reported in October 1995 and November 1996

Systems Reviewed	Departmental Actions	Implications
<i>Income Security Program Redesign (ISPR) at Human Resources Development Canada (HRDC)</i>	<p>In 1995, we reported that the ISPR project needed continuing corrective action by senior management.</p> <p>In 1996, the Treasury Board approved HRDC's submission for:</p> <ul style="list-style-type: none"> • a schedule adjustment and an increase of approximately \$80,000,000 to its budget; and • some changes to the contracted deliveries. <p>The Treasury Board withheld half of the budget increase pending the results of an independent risk analysis of the project. As a result of the risk analysis, management created a special team and gave it the authority to make all the decisions necessary to implement those functions that it believes will deliver the greatest benefits before the year 2000. After December 1997, any further development will be managed in-house.</p>	<p>All future work will be done using "chewable chunks" and detailed requirement specifications for reasonable time horizons, as recommended in our previous audits.</p>
<i>Transport Canada's Integrated Departmental Financial and Materiel Management System (IDFS)</i>	<p>The IDFS was fully implemented in April 1996 at Transport Canada, on time and on budget.</p> <p>A cluster group of users of IDFS and Oracle Financials has been formed. It includes Transport Canada, the National Film Board, Environment Canada, Fisheries and Oceans, and NavCan, a non-government entity.</p>	<p>To better meet changing needs, including full compliance with Year 2000 requirements, an upgrade to a more recent release of the Oracle Financials package upon which IDFS is based, first scheduled for April 1997, is now due for April 1998.</p>

Systems Reviewed	Departmental Actions	Implications
<p><i>Common Departmental Financial System (CDFS) at Public Works and Government Services Canada (PWGSC)</i></p> <p><i>Public Service Compensation System at PWGSC</i></p> <p><i>Canadian Forces Supply System Upgrade (CFSSU) at the Department of National Defence</i></p> <p><i>Tactical Command, Control and Communications System (TCCCS) being developed by National Defence</i></p> <p><i>Transport Canada's Canadian Automated Air Traffic System</i></p>	<p>Since we reported in November 1996, CDFS has been implemented throughout PWGSC. In addition, Correctional Service Canada, Statistics Canada, and several small agencies and clients are using CDFS. CDFS software and infrastructure are also used as part of the new project CFMRS (Central Financial Management Reporting System) that will replace the government's central accounting system.</p> <p>As reported in October 1995, the Public Service Compensation System at PWGSC was terminated.</p> <p>CFSSU represented a high risk of being late, of going over budget and of not meeting Department of National Defence requirements when we reported on it in November 1996. Since then, an intensive effort by National Defence management and the contractor has mitigated the risks by reducing the amount of custom programming needed. National Defence selected an off-the-shelf application rather than a custom-built one. National Defence also rescoped to simplify the systems architecture and to make better use of departmental resources.</p> <p>At an overall cost of \$2 billion, TCCCS represents the largest major capital project in systems development in the government today and its results are critical to the future effectiveness of our land forces. To overcome a six- to nine-month delay in some key segments of the project and operational commitments of the army, the final installation and training plans had to be modified significantly. Mitigation strategies for the numerous remaining risks are being devised and continuously updated. Despite the added pressure of slipping milestones, communications on the project are still open and candid and staff morale is high.</p> <p>The Canadian Automated Air Traffic System we reported on in 1996 was transferred to NavCan in November 1996 and, consequently, is no longer a major software development or major capital project of the government.</p>	<p>PWGSC reports that the reuse of this software represents a possible cost reduction to the CFMRS project.</p> <p>There is a risk that the project may slip three to six months beyond the target date of September 1999, but project management still expects to meet project objectives and the overall budget of \$295 million.</p> <p>TCCCS is projected to be delivered on time, by the end of 2000, and within its overall budget.</p>
<p><i>Real Property Services (RPS) set of projects at PWGSC</i></p>	<p>In our November 1996 Report, we considered the Real Property Services development projects to be high-risk. The Assistant Deputy Minister has since taken a personal hand in re-examining the business cases for the projects, organizing a coherent overall plan, setting priorities on deliverables, encouraging an open sharing of information among the project staff, revising the corporate information technology strategy, and acquiring experienced managers to manage the seven projects left as a result of rescopeing. In partnership with the Government Telecommunications and Information Services branch of PWGSC, management of Real Property Services is implementing the Treasury Board Enhanced Framework for managing systems development projects.</p>	<p>We are encouraged by management's prompt and decisive attention to these matters and consider it to be taking appropriate steps to mitigate the numerous risks that the RPS projects face in their efforts to implement state-of-the-art technology within a rapidly changing business environment.</p>

23.58 In contrast to the contract projects examined in the past, the three in-house projects we reviewed this year were better aligned with the business objectives of the departments, partly because senior management was more closely involved in the planning and the execution of each project. In all cases, special care was taken to break down the project into more manageable components and to produce usable results quickly. There was also better

use of in-house experience in business and systems and better overall communication because project reporting was complemented with informal communication. In-house projects also have the advantage of not being distracted by contract management.

23.59 We are concerned, however, that the level of discipline we found in contract projects, relative to standards, documentation and the management of change requests, is present in only one of the three in-house projects reviewed this year.

23.60 Furthermore, two of the in-house projects carry a high risk of serious problems in the future because of poor planning methodology. In the area of task definition and tracking methodology, all the in-house projects examined are at high risk. Both in-house and contract projects have major deficiencies relative to setting up independent quality assurance functions.

23.61 Areas for improvement. In this year's audit, we looked at all aspects of project management; however, for reporting purposes, we have identified three areas where the best practices of project management are not universally followed and where corrective action is needed to reduce the risks of in-house projects:

- project planning;
- project tracking and oversight; and
- quality assurance, as an independent function.

23.62 Other critical factors. Although we focussed our attention this year on the above-noted three key factors in project management, the successful development and implementation of systems requires a combination of other critical factors that we have been describing over the years:

- senior management involvement;
- sufficient "maturity" or capability for organizations to carry out major information technology projects;
- priorities properly set up and communicated with respect to time, cost and requirements;
- accurate, timely and effective performance measurement;
- effective user involvement and commitment to the success of the project;
- experience and expertise of the staff dedicated to the project; and
- the separation of large projects into smaller, more manageable components, each of which provides an improved capability to the organization.

23.63 To help reduce the risks of overly complex systems under development, departments should take the following actions, whether their projects are undertaken in-house or contracted out to other parties:

- **Clients should be properly identified and involved throughout the project, from the planning stage to the final implementation.**
- **Detailed project plans should be prepared to permit proper project tracking and oversight.**

- **Business cases should be developed in accordance with the Treasury Board Secretariat's guide, *Creating and Using a Business Case for IT Projects (1996)*.**
- **Project charters should be used to clearly establish all the parameters for managing the work and the resources needed for all projects and subprojects.**
- **An independent quality assurance function should be established for all projects.**
- **Subjective assessments of progress should be supplemented with objective measures such as time tracking.**

23.64 We are suggesting the above-noted actions to departments knowing very well that, besides these recommendations, final success in the development of systems in government is a matter of adhering to a whole set of best practices in project management. These best practices are well documented by the industry, in the guidance from the Treasury Board Secretariat and in our reviews of systems under development in government.

Treasury Board Secretariat's response: *The findings of the Auditor General are consistent with the results of the project reviews conducted by the Treasury Board Secretariat in early 1995 and with the subsequent improvement directions documented in the Enhanced Management Framework of May 1996.*

The suggestions and recommendations of the Auditor General are consistent with the views of the Treasury Board Secretariat, particularly as they apply to the first principle of the Enhanced Management Framework — information technology (IT) projects are aligned with, and support, business directions and priorities. The importance of ensuring that the initial planning phase of a project is effectively performed has continually been shown to be critical for the ultimate success of the project.

Additional best practice solutions and a revised training and development program, to be made available in the new year by the Chief Information Officer Branch of the Treasury Board Secretariat, will further assist and support departments in improving their IT project management capacity.

The continuing support of the Auditor General's Office, both formally and informally, in this critical aspect of the government's work is most appreciated.

Revenue Canada's response: *The issues have been presented fairly and factually. Accordingly, no additional detailed response was provided.*

Human Resources Development Canada's response: *The Department agrees with the recommendations presented in paragraph 23.63 and has initiated the following actions:*

1. *Business unit partners will be involved in project planning, development and implementation.*
2. *Project plans will be developed in sufficient detail to ensure proper tracking and management review.*
3. *Business cases will conform to the Treasury Board Secretariat's guide on *Creating and Using a Business Case for IT Projects (1996)*.*
4. *Project charters will be developed for all existing and new projects.*
5. *Quality assurance has been implemented as a separate unit within Self-Service Systems and also within Systems Support and Implementation Services.*

6. *Time tracking will be implemented to the degree sufficient to provide an objective measure of progress.*

Industry Canada's response: *In the fall of 1994, Industry Canada undertook the formidable challenge of making the information highway better available to Canadian businesses through Strategis, by deciding to take advantage of the Internet, which, at the time, was still an emerging phenomenon. This unprecedented effort, which is still being carried out, required the dedicated commitment of all levels of management, with a focus on results. The Department started "small" and knowingly confronted the risks of rapidly changing technology to develop new relationships with its business clients. Today, almost three years later, this initiative has been extraordinarily successful by any measure and it has been widely commended.*

Indeed, the Auditor General's comments in this report must be read in relation to a project that, in terms of the results achieved, has seen remarkable success in regard to clients' acceptance and use, with over one million visits to the site and some 10 million documents downloaded.

Calculated risks, new team-oriented ways of working, rapid prototype development, much faster cycle times, competitive internal business case resourcing mechanisms and a less ponderous management structure were all intentionally used, in order to be at the forefront of the new, fast-moving Internet medium. Quite simply, traditional IT project management methodologies would have been impediments to the timeliness of the required transformation.

Today, given the burgeoning success of Strategis, the Department is having to consider strategies for dealing with growth and increasing client demands that largely surpass initial expectations. Accordingly, we will be implementing steps to provide more stringent quality assurance and business planning, and involving our clients even more closely, but in such a manner as to not bureaucratize the current innovative, dynamic and responsive processes that are working well and providing "real-time" feedback.

About the Audit

Audit objective

The objective of this audit was to conduct risk assessments of three in-house development initiatives relative to best practices in project management.

Criteria

Our audit criteria were derived from best practices described in our 1993 Symposium on Best Practices, from industry best practices, as well as from Treasury Board policies and guidelines. More specifically, we expected that:

- system development efforts done in-house would apply high-quality project management practices;
- when compared with contract projects, in-house system development projects would use similar commonly accepted best management practices; and
- government projects managed in-house would rely on frequent consultations with, communications to, and involvement of potential users.

Scope

In this year's audit, we examined the three in-house systems under development that, at the time of the audit, were the most significant in government by their size and also served Canadians directly:

- the Standardized Accounting and Corporate Tax Redesign project at Revenue Canada;
- Self-Serve Systems at Human Resources Development Canada; and
- the Strategis project at Industry Canada.

As part of our audit, we also reviewed the status of eight other projects that we had examined in previous years:

- the Income Security Program Redesign at Human Resources Development Canada;
- Transport Canada's Integrated Departmental Financial and Materiel Management System;
- the Common Departmental Financial System at Public Works and Government Services Canada;

- the Public Service Compensation System, also at Public Works and Government Services Canada;
- the Canadian Forces Supply System Upgrade at the Department of National Defence;
- the Tactical Command, Control and Communications System also being developed by National Defence;
- Transport Canada's Canadian Automated Air Traffic System; and
- the Real Property Services set of projects at Public Works and Government Services Canada.

Approach

Our audit approach was the same as that used in previous years in auditing systems under development. In examining the implementation of in-house systems under development, we again conducted a risk assessment of the management of individual projects to determine what hinders or facilitates their successful completion and, as a corollary, to determine what lessons can be learned and shared among other projects.

Audit Team

John Adshead
Sylvain Amyotte
Tony Brigandi
Bob Cardillo
Guy Dumas
Marvin Schwartz
Caroline Smallman
Peter Taylor

For information, please contact Eric Anttila, the responsible auditor.

Chapter 24

Agriculture and Agri–Food Canada - Prairie Farm Rehabilitation Administration

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Agriculture and Agri–Food Canada - Prairie Farm Rehabilitation Administration

Assistant Auditor General: Don Young

Responsible Auditor: Neil Maxwell

Main Points

24.1 Over the last six decades, the Prairie Farm Rehabilitation Administration, a Branch of Agriculture and Agri–Food Canada, has adapted its role to the changing demands for reclaiming land, developing water supplies and addressing sustainable development of the rural Prairie landscape. Its familiarity with local conditions, such as the risks of flooding in Manitoba, and its network of offices across Western Canada have enabled it to collaborate with provinces, producers and community–based businesses.

24.2 Although the Branch has adapted to the changing needs of the Prairies, it needs to clarify its strategic direction and priorities, linking its Business Plan, its operational planning and decision making and its financial planning to the results it expects to achieve.

24.3 Consistent with the Department’s transition toward results–based management, the Branch has begun developing a results–oriented, targeted approach to planning and delivering its programs and the rural development agreements in which it participates with others. However, efforts to develop mechanisms to define, categorize, cost and prioritize regional needs within the scope of its mandate need to be accelerated.

24.4 Co–operative working relationships with an extensive network of partners across the Prairies have served the organization well. At the same time, there is an opportunity for the Branch to play a catalytic role of leadership with other levels of government to eliminate gaps in program delivery related to water quality, inventory and supply.

24.5 Approximately 698 full–time–equivalent staff deliver Prairie Farm Rehabilitation Administration programs from 30 offices, at a cost of approximately \$70 million per year. While the Branch has acted on a number of opportunities for cost reduction and cost avoidance, it continues to operate the programs and to plan future activities without reassessing the need for existing resource levels.

24.6 Cost recovery has been implemented for approximately \$10 million of its services, but there is an opportunity to expand these cost recovery initiatives. There is inconsistency in what is presently recovered. We are concerned that the public cost of certain activities may be disproportionate to the public good received.

Introduction

24.7 Agriculture and Agri-Food Canada is organized into eight branches. For reporting to Parliament, departmental programs are divided into six activities:

- Agricultural Research and Development;
- Policy and Farm Economic Programs;
- Market and Industry Services;
- Rural Prairie Rehabilitation, Sustainability and Development;
- Corporate Management and Services; and
- Canadian Grain Commission.

24.8 The Rural Prairie Rehabilitation, Sustainability and Development activity is delivered through one of the branches, the Prairie Farm Rehabilitation Administration. This departmental activity accounts for gross planned expenditures of \$ 74.9 million including an estimated \$10.4 million in revenues, for net expenditures of \$64.5 million in 1997-98. These expenditures represent 5.2 percent of the Department's total budget.

24.9 The Prairie Farm Rehabilitation Administration was established in 1935 to administer the *Prairie Farm Rehabilitation Act*. The scope of the Act is to secure the rehabilitation of drought and soil drifting areas in the Provinces of Manitoba, Saskatchewan and Alberta by the development and promotion of systems of farm practice, tree culture, water supply, land utilization and land settlement that will afford greater economic security. The Prairie Farm Rehabilitation Administration became a Branch of the Department of Agriculture in the 1950s. In 1969, it was transferred to the Department of Regional Economic Expansion and was returned to the Department of Agriculture in 1983.

24.10 As shown in Exhibit 24.1, the Prairie Farm Rehabilitation Administration provides a variety of programs and services designed to promote resource care and rural growth. Its Business Plan defines "resource care" as "using Prairie land and water resources in a manner which can be sustained indefinitely" and "rural growth" as developing "a robust, growing and diversified economy within the rural agricultural areas of the Prairies." The Department has also used the Branch to deliver a wide variety of programs ranging from those that dovetail directly with the original mandate of the Branch to those that are of a significant departmental and government-wide priority. The Department sees the Branch as a key contributor to the Department and its broader policy agenda. At the time of our audit, the Department was in the process of ensuring that all its activities were aligned to support the achievement of its business lines. The Branch is seen as an important contributor to two of these business lines:

- Innovating for a Sustainable Future; and
- Strong Foundations for the Sector and Rural Communities.

Exhibit 24.1

(This exhibit is not available, see the Report)

Focus of the audit

24.11 The objective of the audit was to assess management practices with a view to determining whether specific areas require significant improvement. The focus of the audit was the Prairie Farm Rehabilitation Administration and the co-ordination of its programs and activities with those of other organizations in the Department. For additional details, see the section entitled **About the Audit** at the end of the chapter.

Observations and Recommendations

Strategic Direction, Objectives and Priorities

24.12 Only 5 percent (about 46 million hectares) of Canada's vast terrain is suited to crop production, of which 85 percent (about 39 million hectares) is in the Prairie provinces. According to a departmental report entitled "The health of our soils, towards sustainable agriculture in Canada", soil degradation is the most serious threat to the agriculture industry in the long term. For example, recent studies have shown that 5 percent of cultivated Prairie farmland is at high to severe inherent risk of water erosion, and 20 percent of the cultivated land continues to be at risk of moderate to severe wind erosion.

24.13 The Branch is proud of its culture of responsiveness in helping individuals, organizations and communities (see Exhibit 24.2). This commitment is reflected in its stated mission of "working with Prairie people to build a viable agricultural industry and to support a sound rural economy" (for example, providing technical irrigation expertise), "healthy environment" (such as for town water supplies and sewage treatment) "and a quality of life upon which agriculture depends". The primary objective of the *Prairie Farm Rehabilitation Act* is to rehabilitate the drought and soil-drifting areas in the Prairie provinces, and to develop and promote systems of farm practice that will afford greater economic security. Over the past 10 years, the organization has also administered and delivered to farm and non-farm clients an increasingly wide array of programs and services outside its traditional activities.

Exhibit 24.2

Responding to the Risks of Flooding

The Prairie Farm Rehabilitation Administration's culture of responsiveness is evidenced by its role during the 1997 flooding of the Red River Valley of Manitoba.

To assist in the flood preparations, the Prairie Farm Rehabilitation Administration:

- led the departmental emergency response team;
- assembled data from various sources on, for example, locations of farmstead and livestock operations, and translated the data into its Geographic Information System (GIS). This information was made available to the Armed Forces, Royal Canadian Mounted Police, and the Canadian Coast Guard for their respective evacuation and monitoring activities;
- prepared an inventory of available pumps within the Prairies for the Emergency Management Operations and assisted with the installation of a 23 km overland water pipeline to provide a supply of potable water;
- relocated 19 survey crews to help calculate a suitable height for temporary dikes and provided administrative staff to assist with evacuation preparations; and
- made available two community pastures for livestock evacuation.

24.14 Local delivery, responsiveness to client needs, and adapting its role to changing demands are essential characteristics of the operations of the Prairie Farm Rehabilitation Administration. Its familiarity with local

conditions, such as the risks of flooding in Manitoba, and its network of offices across Western Canada have enabled it to collaborate with provinces, producers and community-based businesses. Although Part III of the Estimates makes no reference to it, Client Services is an activity that the Prairie Farm Rehabilitation Administration considers significant to its operations. This is an advisory/consultative service that has many aspects, ranging from providing technical assistance in the form of analysis and project advice to facilitating partnerships with other levels of government, agencies, groups or departments. It also extends to helping clients access financial assistance through existing “sunset” programs and agreements delivered by the Branch, and other federal and provincial programs that might be useful to them. According to the Prairie Farm Rehabilitation Administration, the Client Services activity expends between 5 and 10 percent of regional budgets.

24.15 This culture of responsiveness is now being tested by pressures on the Branch to provide additional services, including work in such diverse areas as rural economic development and ecotourism. Many of these activities have extended beyond the Branch’s 1935 legislative mandate to manage Prairie soil erosion and water development, and to develop and promote systems of farm practice that will afford greater economic security.

24.16 The organization’s domain has also been realigned geographically. In 1989, it expanded beyond the original three Prairie provinces to undertake activities in parts of northern British Columbia, where conditions are similar to areas in northern Alberta. It has gone on to reallocate resources for additional regional offices in northern Alberta and northern Saskatchewan. During the same period, the financial resources, number of staff and technical expertise available to service this diverse demand have been reduced. Throughout this time of expanding activities along with geographic extension, shrinking resources and decentralization, the needs and demands for land and water management have continued.

Need to define strategies for dealing with soil and water rehabilitation

24.17 Given this period of transition, we expected to find a detailed Business Plan describing new strategies, priorities, objectives, working relationships with other government agencies, and resource adjustments.

24.18 We found that the 1997-98 Prairie Farm Rehabilitation Administration Business Plan is deficient in many key areas. It does not define a clear strategic direction for current and emerging land and water issues that impede rehabilitation of the agricultural Prairie landscape. It does not identify what is to be achieved in which locations, and over what period of time. Nor does the Plan indicate how funds and resources will be allocated to achieve the strategic objectives in view of increasing and divergent demands.

24.19 As shown in Exhibit 24.3, approximately \$40.1 million of the Branch’s \$74.9 million budget for 1997-98 is directed to resource care. The remaining \$34.8 million (46.5 percent of the budget) is focussed on rural growth. Approximately 200 of the Branch’s 698 staff are allocated to work in this area and are facing a reduction of more than \$20 million in agreement funding. Yet the Business Plan makes no mention of how this reduction will affect rural growth program delivery or human resource allocation.

Prairie Farm Rehabilitation Administration Budget Allocation

Year	Resource Care		Rural Growth		Total (\$000)	Total (full-time equivalents)
	Budget Allocation (\$000)	Human Resource Allocation	Budget Allocation (\$000)	Human Resource Allocation		
1997-98						
Core Funding	40,100		13,500		53,600	
Agreement Funding	—		21,300		21,300	
Total	40,100	498	34,800	200	74,900	698
1998-99						
Core Funding	40,300		12,500		52,800	
Agreement Funding	—		30,600		30,600	
Total	40,300	495	43,100	198	83,400	693
1999-00						
Core Funding	40,200		12,700		52,900	
Agreement Funding	—		—		—	
Total	40,200	495	12,700	198	52,900	693
2000-01						
Core Funding	40,200		12,700		52,900	
Agreement Funding	—		—		—	
Total	40,200	495	12,700	198	52,900	693

24.20 The Department acknowledges that the Business Plan has shortcomings, but sees it as an important first step in order that the Branch may articulate clearly its strategic direction in the near future. We note, as well, that the Branch recognized the need for a new planning framework at the time the government's revised Expenditure Management System was announced in 1995, and began a regional work planning process and a new Branch business planning process. Unfortunately, these annual plans prepared by the Branch's regional and district offices are also limited by the absence of a clear strategic direction. The Prairie Farm Rehabilitation Administration is a highly decentralized service organization that develops 5 regional plans and 22 unique district work plans each year, in response to general guidance from headquarters and to specific local issues. Our review of these plans identified a wide range of interpretations of the Branch's strategic direction.

24.21 We were unable to find a definitive or consistent statement of what rehabilitating the Prairies means today or will mean in the future. Branch representatives were unable to clearly define what or who is to be included in, or excluded from, rehabilitation and what these terms mean in the context of the *Prairie Farm Rehabilitation Act*. This broad interpretation of direction and terminology is reflected in the wide regional variations in allocation of resources, setting of priorities, and procedures for project monitoring and inspection.

24.22 The lack of a shared understanding of terminology and strategic direction has the potential to impede the pace and consistency of rehabilitation across the Prairie landscape. Without reference to a management strategy to guide and target activities, it is difficult to see how the Prairie Farm Rehabilitation Administration can act with cohesion, either internally or with its partners. Such a management strategy needs to be formulated in concert with other federal-provincial agencies and agri-food stakeholders, with the Branch acting as a leader and catalyst.

24.23 The need for co-ordination with other levels of government has become increasingly evident from the nature and magnitude of emerging agricultural and environmental issues facing the Prairie provinces. One gap in program delivery identified by both the Prairie Farm Rehabilitation Administration and provincial officials was in

monitoring the quality, quantity and location of surface water and groundwater. This information is important as a basis for future decisions on economic development and environmental sustainability. It also highlights important health issues. For example, in the early 1990s a federal–provincial assessment of water quality in one province found that 258 of 528 communities surveyed were having water quality problems. Most of them could not meet health–related objectives, or lacked minimum water treatment. Some simply did not test their drinking water at all. Water quality issues are beyond the sole responsibility of the Branch, and hence addressing them requires co–ordination of federal, provincial and municipal efforts.

24.24 The first task in setting strategic policy direction and objectives for the future is to clarify the broad statement of intent in the *Prairie Farm Rehabilitation Act*, namely, rehabilitation of the drought and soil drifting areas in the provinces of Manitoba, Saskatchewan and Alberta by the development and promotion of systems of farm practice, tree culture, water supply, land utilization and land settlement that will afford greater economic security. This statement needs to be transformed into clear, consistent and measurable objectives to provide a basis for program design, management and accountability.

24.25 **The Prairie Farm Rehabilitation Administration should define and prioritize current and emerging land and water management issues on the Prairies, identify the associated resources required and, in concert with the provinces, other federal agencies and industry, develop strategic objectives with measurable outcomes. The strategic direction should be outlined in its Business Plan and put into operation in each of the regions.**

Department's response: The Department appreciates the Auditor General's recognition of PFRA's continuing ability to adapt to changing circumstances.

Although the Branch has proven its ability to identify and respond to emerging priorities, it recognizes that the current pace of change across the agriculture and agri–food sector, coupled with declining departmental resources, necessitates a more strategic, results–oriented approach to the planning and delivery of its activities. To this end, and as part of the Department's transition toward results–based management, PFRA is actively participating in the development of the Department's Performance Reporting and Accountability Structure (PRAS). The PRAS will clearly articulate, in measurable terms, the outcomes that the Department is working to achieve on behalf of Canadians. Ultimately, it will drive specific planning and resource allocation within the Department, using a business line approach to management — ensuring that departmental resources are targeted toward the achievement of results.

As part of this broader departmental effort, PFRA is working to more clearly define its strategic and operational objectives as well as resource requirements for key result areas where it has sole or shared accountability with others. PFRA will continue this work in keeping with its history of co–operating with partners and stakeholders to make sure its services are complementary to those provided by others. Sustainable development will continue to be a cornerstone of PFRA's efforts on the Prairies. This will be reflected in future Business Plans.

Aligning Programming and Resource Allocation with Priorities

Requirement for results–oriented programming based on greatest need

24.26 The Prairie Farm Rehabilitation Administration needs to make better use of existing strategic information to implement and develop programs. Reorganization of the Branch during the fall of 1992 resulted in the formation of a Geographic Information Services Unit that concentrates solely on the development of geographic information systems (GIS). Considerable information was added to the geographic information systems during the delivery of the Western Grain Transition Payments Program, which was completed in the spring of 1997. GIS is a technological tool that collects and presents information and more accurately positions and maps high–risk areas.

The Branch is using GIS as an analytical tool but, as Exhibit 24.4 illustrates, the Branch has not yet used this information to assess and target areas of highest risk.

Exhibit 24.4

Shelterbelt Centre, Indian Head, Saskatchewan

In 1902, the Department of the Interior established the Shelterbelt Centre. As the Centre's name implies, its original purpose was to produce and distribute trees to provide shelter from the wind, thus reducing soil erosion and improving snow management. Between 5 million and 7 million tree seedlings are distributed annually to approximately 10,000 recipients (farmers, ranchers, First Nations, towns, villages and cities, owners of small rural holdings, and charitable organizations), mainly in Manitoba and Saskatchewan, at an annual cost of approximately \$3 million. Between 1,500 and 2,000 km of field shelterbelts are planted each year. The Prairie Farm Rehabilitation Administration has the tools to monitor the Prairie landscape by remote sensing (satellite photography) in conjunction with its own geographic information systems (GIS). Such information is able to reveal areas of highest risk to soil.

Although the Branch has the information/intelligence to determine areas of highest risk to soil, available tools are not being used to identify locations requiring different amounts of soil damage prevention by tree shelterbelts, to rank priority planting areas, and to assess total needs for tree seedlings to reduce field soil erosion and improve snow management in the Prairie landscape. For example, numerous reports received by the Prairie Farm Rehabilitation Administration indicate that the drought of the 1980s has reduced the life span of existing shelterbelts. We were unable to identify a Branch strategy to address the impact of these major droughts on shelterbelts, nor is there a clear statement of what it expects to be accomplished over specific time frames.

24.27 Strategic information was also used to develop the Permanent Cover Program. This program was initially a Western Canada component of the National Soils Conservation Program (\$24 million) and continued under the Farm Support and Adjustment Measures Program (\$50 million). Both components provided assistance to producers to address specific soil degradation problems in each province.

24.28 After consulting with producers, Branch officials made a strategic decision to target marginal lands, based on degradation potential using soil class and municipal land assessments. Marginal lands were defined as those at high risk of wind or water erosion, those with high salinity, and those with acidic or problem "solonetzic" soils. Soil classes 4, 5 and 6, as defined by the Canada Land Inventory, were used as a practical approximation of these soils. These lands would provide a much lower yield of cereal crops unless inputs (fertilizers, etc.) were significantly increased, and would provide only a marginal rate of return to the producer. Land use and soil conditions were evaluated and classified, and maps of high-risk and problem soil areas were prepared for each Prairie province. The maps were used to estimate the amount of marginal land at 5.8 million hectares, or approximately 15 percent of the total cultivated area in the Prairie provinces (39 million hectares). Options to address the problem areas were then explored and producers were consulted further. The resulting program provided a payment to producers to convert eligible land to perennial forage or tree cover.

24.29 The Permanent Cover Program removed roughly 0.52 million hectares of marginal land from annual crop production, at a cost of \$74 million. It was considered a success, based on the results of a client survey and interviews of provincial agencies. However, as displayed in Exhibit 24.5, many of the Permanent Cover Program agreements with farmers fall outside the concentration of marginal land identified during the program design stage.

24.30 Although strategic information was used to guide the design of the Permanent Cover Program, this identification of areas of high risk and problem soils was not used to guide program implementation. Recognizing that smaller parcels of marginal land can exist within individual farmers' cultivated lands and yet fall outside the large tracts of marginal land identified on the Prairie-wide landscape map, the Branch made the program available across the Prairies. As a result, the program as implemented was not targeted to specific concentrations of class 4, 5, and 6 land. Each land parcel application was evaluated using a variety of tools, including municipal assessment information, aerial photography and on-site inspections.

24.31 Regions and districts were not given specific goals for the amount of land that was to be removed from production in each geographic area or the relative importance to be given to, for example, class 6 land (severe cultivation risk) and class 4 land (moderate cultivation limitations). The percentage of cultivated marginal land most

at risk of soil erosion (classifications 5 and 6) that was successfully removed from production is not known. The actual average production per acre removed was 18.29 bushels in Manitoba, 11.31 bushels in Saskatchewan, 18.41 bushels in Alberta, and 27.4 bushels in the Peace River District of British Columbia. We were told that the uptake for the program in the Prairies depended on the amount and location of cropped marginal land, the initiative of district staff, and knowledge of this new program among land owners. The lack of specific targets or incentives in those areas where there was a concentration of marginal land provides a partial explanation for the uneven distribution of program sites among districts, shown in Exhibit 24.5.

Exhibit 24.5

(This exhibit is not available, see the Report)

Consistency required in project identification, evaluation and selection

24.32 As budgets continue to decline, the need becomes much greater for a systematic decision-making process in order to be fair and to obtain greatest value for money. Lower-priority projects may have to be stopped and resources redirected. Current government restraint comes at a time when the objectives of the Prairie Farm Rehabilitation Administration are expanding to take into account economic and social issues as well as traditional issues of resource sustainability.

24.33 There are significant differences among regions and districts in program services delivered. The demand for such services, and the available time of staff, depend on the number of programs being delivered in the region, the characteristics of the region, and producers' knowledge of the programs. Given that the regions and districts have comparable resource levels, the variability in demand leads to the provision of different services. In the Rural Water Development Program, for example, water supply for domestic use can receive financial assistance in the south Saskatchewan region, but not the southern Alberta region. There are also differences in the amount of direct contact staff members have with program recipients. In the Dawson Creek District of British Columbia, staff may visit a producer's farm three times to assess the feasibility of a project, assist in preparing the application, and inspect the finished project. In contrast, for many projects in the Brandon District of Manitoba there is no staff contact with the producer. The application is received and approved, and funds are disbursed on receipt of evidence that the project has been completed.

24.34 There is also significant variability in the processes for prioritizing projects at the district office responsibility centres and determining the appropriate level of funding for a particular project. Each of the 22 district offices has its own method of choosing which rural water development projects will be funded within general guidelines. We also found that the Prairie Farm Rehabilitation Administration has provided technical support for a wide variety of water supply projects, including wells, regional pipelines, water supplies for economic development, and uses for waste water. Yet we found little guidance on what types of activity merited support. While overall outcomes are determined by local demand and activities, without a systematic decision-making process to direct resources to maximum benefit and guide project selection by district offices, there is a risk that federal funds are not being put to optimum use.

24.35 Although it is an organization with a highly decentralized decision-making system, we found that the Prairie Farm Rehabilitation Administration has not established qualitative and quantitative decision-making tools to assist responsibility centres in selecting among competing projects. They need these tools to help them answer the following questions: Is it a good investment? What resources should be allocated? How should success be defined?

24.36 While it is appropriate that the Prairie Farm Rehabilitation Administration tailors its programs to meet regional differences, it has not yet established which activities should be given priority under which circumstances, or defined an appropriate level of resources for optimum program support. As we have already indicated, the Branch's corporate objectives are too general to enable it to do so and they do not specify what is to be achieved, in which locations, and over what periods of time.

Regional resource allocation not linked closely to needs

24.37 We expected that in conjunction with defining its objectives in measurable terms, the Prairie Farm Rehabilitation Administration would optimize and target its activities to achieve the objectives cost-effectively.

24.38 Each Prairie Farm Rehabilitation Administration region or district is unique. Considerable environmental, social and economic differences exist among them. For example:

- the potential water supply and corresponding development techniques vary across regions and districts;
- the population density varies from district to district;
- the types and number of farms and commodities produced vary;
- the risks of soil erosion, drought, or flood vary from district to district; and
- local priorities vary.

24.39 In the interlake region of Manitoba (Beausejour District), groundwater is shallow and readily available. As a result, individual wells are usually less than 100 feet deep. With the end of the Western Grain Transportation Subsidy, the Department expects to see an increase in forage crops and cattle production. There has also been an expansion in the number and size of hog barns and this trend is expected to continue, with the region doubling its hog production over a five-year period. These increases in livestock production can present an increased risk of groundwater contamination if proper manure management procedures are not followed.

24.40 In contrast, groundwater in west central Saskatchewan (Rosetown District) is not always available, wells are often 300 to 400 feet deep, and the quality of the groundwater is poorer. Producers must often rely on surface water, and many have dugouts that are more than 10 years old. The quality of surface water is also a problem, and in many instances the water is not treated to remove bacteria. An option, equally unattractive, would be to truck the water needed for farm and domestic use from some distance away. In this region the Branch favours rural pipelines, as they provide a more dependable and better alternative. The population of the district is approximately 45,000.

24.41 The Red Deer District in central Alberta represents our final look at different characteristics. The population of this district, not including Calgary, is over 300,000, more than 15,000 of whom are farmers. Unlike most other parts of the Prairies, this district has seen an increase in the number of farms in the past 15 years. Surface and groundwater normally are readily available to the western two thirds of the district. With good transportation and water source, this area has a number of intensive livestock operations and cattle grazing areas whose runoff impacts on surface water quality. Nearby urban water treatment plants often have difficulty dealing with high contaminant loads. The land use objectives of urban and rural inhabitants are often in conflict.

24.42 We found that in spite of these differences, the Rural Water Development Program budget is divided evenly among the five regional offices rather than reflecting each region's individual requirements.

24.43 The Prairie Farm Rehabilitation Administration uses a similar approach to resourcing each of its offices. All have comparable, if not identical, staff structures and do not reflect district and regional differences. While discussing this across-the-board approach with Branch management, we were told that competing economic, environmental and rural development objectives tend to neutralize local differences.

24.44 The Prairie Farm Rehabilitation Administration should identify the areas of the Prairie landscape at greatest risk and most in need. It should develop a strategic implementation plan identifying how these needs will be prioritized and acted upon, and what results are to be achieved.

Department's response: PFRA uses a variety of analytical tools in order to assess risks and identify needs related to land and water capability on the Prairies. Information gathered through the use of such tools enables PFRA to evaluate the extent to which potential projects identified by stakeholders and clients can be expected to contribute to rural sustainability on the Prairies with an appropriate benefit to Canada. Geographic Information Systems is one such analytical tool, which, as the Auditor General recognizes, has only been at PFRA's disposal for a relatively short period of time. As GIS data become available on a Prairie-wide and/or regional basis, its cost-effective use as one of several available inputs to the Branch's strategic and action planning process will be enhanced.

In keeping with the strategic direction, methods of assigning priority to projects and regions will be developed along with the appropriate performance criteria.

Sunset programs impact on the delivery of core programs

24.45 Over the past 20 years, the Prairie Farm Rehabilitation Administration has been called upon increasingly by the Department to deliver a wide variety of fixed-term or "sunset" programs. Many of these are cost-shared with the provinces, and have included livestock and crop drought assistance, Green Plan agreements, rural economic development agreements, and the Western Grain Transition Payment Program, among others. The role of the Prairie Farm Rehabilitation Administration in planning and implementing these programs has ranged from leadership to facilitation.

24.46 While some of these sunset programs may complement and enhance the Branch's core programs, others are not directly related to these traditional activities.

24.47 We were advised by Prairie Farm Rehabilitation Administration officials that the trend to programs with fixed terms is expected to continue. The human resources to deliver these additional programs have often been drawn from the existing staff pool of the Prairie Farm Rehabilitation Administration. Many Branch managers informed us that even where funds have been provided, the transfer of experienced and professional staff to non-core programs may have affected the delivery of core programs.

24.48 This expanded program workload has affected, to varying degrees, the district offices' ability to deliver core programs. For example, at most of the seven district offices we visited, soil conservationists had been diverted from regular activities to manage the Permanent Cover Program during its delivery period. Similarly, district water management experts had been reallocated to administer federal-provincial water development programs or waste treatment projects in Saskatchewan and Manitoba.

24.49 The demands of sunset and special programs have also highlighted a mismatch between the locations of the 22 district offices and the areas of greatest demand. Saskatchewan districts have had to administer a greater number of programs, including the Partnership Agreement on Rural Development, the Partnership Agreement on Water-Based Economic Development, the Permanent Cover Program and Green Plan projects. They also provide administrative services for the community pastures. Alberta districts, however, have had to administer only the Permanent Cover Program and Green Plan projects. Districts in Saskatchewan and Alberta have identical levels of resources, even though the delivery burden is greater in Saskatchewan.

24.50 We are not suggesting, by these comments, that it is inappropriate for the Branch to be used to deliver sunset programs that are not directly related to its core activities. In some cases, its familiarity with local conditions and its network of field offices across Western Canada make it an attractive alternative to creating a new delivery mechanism to implement sunset programs.

24.51 However, one of the key strategic questions that the Branch and the Department need to address is how to strike the appropriate balance between core and sunset programs. They also need to consider the related question of whether the Branch can continue to divert substantial resources away from core programs for lengthy periods of time without compromising the effectiveness of these core programs.

24.52 In making decisions to task the Branch with delivery of future sunset programs, the Department should analyze and consider the potential impact on the Branch's core programs and whether existing Branch funding and staff resources are sufficient to deliver both effectively.

Department's response: The Department and PFRA share a good deal of pride in PFRA's proven track record as an organization that has successfully delivered sunset and other programs to Western Canadians effectively and efficiently. This track record was recently reinforced by the Auditor General's positive assessment of PFRA's delivery of the Western Grain Transition Payments Program. PFRA's decentralized organization and land- and water-based implementation capabilities give it a unique capacity for client-direct delivery. For these reasons, the Department has turned to PFRA as the organization best positioned to address a number of key departmental priorities.

It should be noted that PFRA's mandate extends beyond the PFRA Act to include the delivery of other departmental programs, providing flexibility in determining how PFRA can best help the Department address key priority areas while meeting its obligations under the Act.

The Department affirms the importance and continued relevance of PFRA's core mandate. New demands for PFRA services will be assessed in light of all relevant factors.

Need for a consistent approach to inspection and monitoring

24.53 The Prairie Farm Rehabilitation Administration works with or through many partners and clients. Its objectives may not always be the same as those of the people it is working with. Hence, it needs mechanisms to ensure that the results of specific activities are those that were intended.

24.54 We expected that the Prairie Farm Rehabilitation Administration would have risk-based quality control and cost control procedures in place to ensure that projects are implemented as specified in the program design.

24.55 We found that the Branch's approach to monitoring and inspection is inconsistent. For example, in the districts we visited we found that the soil conservationists spend time every year monitoring the land taken out of cultivation by the Permanent Cover Program. In contrast, only some districts inspect individual Rural Water Development Program projects upon completion. In many cases, we could find no evidence of a site visit after a water well was drilled, or that a project's long-term effectiveness had been evaluated. Similarly, it was unclear how the planting and performance of shelterbelt trees are being monitored under the shelterbelt program.

24.56 The Prairie Farm Rehabilitation Administration should implement a consistent, cost-effective and risk-based program of monitoring and inspection.

Department's response: The Branch has monitoring and inspection systems in place for the majority of the programs it operates. In the case of the Rural Water Development Program, projects accounting for over 75 percent of the program expenditures are inspected. The Department is of the opinion that the cost of conducting inspections for small individual projects could exceed the value of Canada's contribution. PFRA will improve on the methods of reporting inspection activity and develop guidelines for this purpose.

Opportunities to Improve Cost Effectiveness and Cost Recovery

Opportunities for cost savings exist

24.57 Programs and services that are delivered by Branch staff across the Prairies are complemented by an extensive network of partnership agreements with federal, provincial and municipal agencies. The composition of the staff is presented in Exhibit 24.6.

Exhibit 24.6

(This exhibit is not available, see the Report)

24.58 Of the 698 full-time-equivalent staff, approximately 260 are located at the regional and district offices. Another 265 manage 915 thousand hectares of community pastures, a tree nursery and two research and demonstration centres.

24.59 As shown by examples in Exhibit 24.7, the Prairie Farm Rehabilitation Administration has made progress over the last 10 years in reducing costs in a number of areas.

Exhibit 24.7

Examples of Progress in Reducing Costs

- During 1993-94, the Prairie Farm Rehabilitation Administration reduced its geotechnical division from 50 people to 12. These positions were eliminated or reassigned and the function that remains is performed by using outside contractors.
- As part of Program Review, it cut 8 percent of its staff budget. Most of these cuts were in administrative positions, in an attempt to minimize the direct impact on service to clients. The method of dealing with the reductions entailed increasing the authority delegated to the regional and district offices, thereby decreasing the need for administration in the head office in Regina.
- The government's Work Force Adjustment initiative resulted in a staff reduction of 74 people when those employees took advantage of the Early Retirement and Early Departure Initiatives.
- Over the past 10 years, shared management has been implemented at 24 of the 87 community pastures.

24.60 Each of these reductions focussed on a particular aspect of the Prairie Farm Rehabilitation Administration, or was carried out to comply with Department-wide cuts in spending at a particular time.

24.61 There has also been some progress in other areas of cost avoidance. Most significant is the emphasis placed on collocation, with some Prairie Farm Rehabilitation Administration district offices and one regional office sharing accommodation and support services with other branches of the Department, or with provincial counterparts. In 1995, the Prairie Farm Rehabilitation Administration reduced its vehicle fleet as part of a Department-wide initiative. Over the past five years, it has reduced its number of vehicles by a total of 37 to approximately 400, or by 9 percent. However, in the same period of time its staff has decreased by 17 percent. The ratio of vehicles to staff has not been reduced. This is partially explained by the fact that many of the staff reductions in the past five years were in administrative positions, which never required the use of a vehicle; and technical staff were relocated from headquarters to the district offices, where they did need a vehicle.

24.62 We expected that as part of implementing its new vision and mission statements, the Prairie Farm Rehabilitation Administration would have developed a strategy to realign its resources geographically, providing greater operational flexibility to respond to shifting needs. An appropriate realignment strategy would entail office expansion/closure/downsizing in line with changing demands and resource availability. We found that no strategy of this nature has been developed and resources have not been redeployed. Their current distribution is shown in Exhibit 24.8.

Distribution of Resources among Regions and Districts

	Alberta/B.C.	Saskatchewan	Manitoba	Total
Number of Regional Offices	2	2	1	5
Number of District Offices	8	10	4	22
Staff	89	119	52	260
Regional Operating Budget (\$000s)	4,675	6,020	2,749	13,444

24.63 A challenge for the Branch is to promote effective leadership and to be proactive in fields where there are many existing and potential partners. We observed that provincial governments in the Prairies are also active in the fields of rural development and water and soil conservation and development. In one district we visited, we found at least 40 different federal, provincial, regional, municipal, and industry groups and associations all working in the area of economic development. The need to co-ordinate program delivery will intensify between 1997-98 and 1999-2000 as existing sunset programs expire, reducing the Prairie Farm Rehabilitation Administration's budget from \$74.9 million to \$52.9 million (see Exhibit 24.3).

24.64 Much of the Branch's ability to be proactive depends on its ability to collect and analyze information on very diverse subjects, from conservation farming to endangered species. At the same time, other public sector and private sector groups are performing similar functions. There is an opportunity to reduce costs by sharing with other organizations not only information gathered but also analysis performed.

24.65 To ensure that gaps are avoided and overlap and duplication minimized, agreement needs to exist on not only the nature and level of the program being delivered by each party but also the responsibilities of each party. This includes managing issues such as the gathering, maintenance and analysis of data. We found that the Branch and the provinces tend to independently gather, maintain, organize and analyze information/intelligence for use in developing policies and programs.

24.66 The Prairie Farm Rehabilitation Administration has a memorandum of understanding with the provinces on several areas of responsibility (for example, water development). It has also begun to work with one province to develop and negotiate a memorandum of understanding outlining their respective responsibilities for program delivery. The various aspects of program development and monitoring are currently being developed.

24.67 An opportunity for the Prairie Farm Rehabilitation Administration to meet the challenge of its mandate with reduced resources is to "lever" its resources with the aid of partners. Its broad, ecologically based mandate to address "drought and soil-drifting areas" leaves it uniquely situated to do this kind of leveraging. The mandate cuts across four provincial boundaries and interacts with the mandates of departments at both the federal and provincial levels. For example, agriculture is a shared federal-provincial responsibility; and water quality and supply are managed by departments and agencies at both the federal and provincial levels. The Prairie Farm Rehabilitation Administration has an opportunity to be a powerful integrating force for management and change across the entire Prairie landscape. It can also use this opportunity to amplify the effect of its diminishing resources.

24.68 The Branch needs to balance external demands with its core program mandate, reach agreement with the provinces and with other federal agencies on roles, responsibilities, and results to be achieved, and align its resources and technical expertise accordingly.

24.69 The Prairie Farm Rehabilitation Administration should reassess the geographic distribution and cost effectiveness of its current network of offices and resources in line with its evaluation of strategic issues, needs and potential partners.

Department's response: With its reorganization in 1993, PFRA reallocated resources to a wider network of district and regional offices to improve geographic coverage and client access within the area it services. Efforts to clarify the Branch's strategic direction, currently under way, will facilitate further assessment of resource allocation taking into account differences in local needs and opportunities across the Prairies region.

Some costs are being recovered

24.70 In 1989 the government released a policy on the recovery of revenue for services provided by the federal government. The objectives of this policy are:

- where appropriate, to promote fairness by shifting the costs of a particular program or activity from taxpayers at large to those specific users who benefit most directly from them;
- to promote a more efficient allocation of resources by introducing a market-type discipline on the demand for and the supply of goods and services.

24.71 Departments were expected to review their programs to determine whether consideration should be given to requiring users to pay “their fair share of the costs of services and facilities, and appropriate fees for rights or privileges.” In areas where fees are appropriate, “departments must develop their own strategies on what should be charged for, how much will be charged, and who will pay.”

24.72 Government direction on revenue generation encourages departments to generate revenue from the products of research activities that have market and revenue potential — for example, hybrids of plant species, farm animals, and equipment.

24.73 The principle of sharing the cost of services with those who derive a private benefit from them was endorsed in the federal Budgets of 1993, 1994 and 1995.

24.74 We expected the Prairie Farm Rehabilitation Administration to have clearly defined strategies of cost recovery for services, based on user profiles and a pricing rationale. In addition, we expected that it would have identified opportunities to generate revenue.

24.75 In presentations to the House of Commons Standing Committee on Agriculture and Agri-Food, the Department outlined the basic principles of cost recovery that it has been following. “Our approach to program redesign is a blend of cost reduction, cost avoidance and cost recovery....Cost recovery will apply to those activities from which private benefit is attained....Cost recovery will be applied equitably for similar activities and commodities of comparable risk.”

24.76 The Land Management Service, which accounts for 35 percent of the Branch's operating costs, is a program area that has been involved in cost recovery since 1939. The 87 community pastures operated by the Branch were introduced in 1937 to remove marginal and unsuitable lands from crop production. Cattle producers (patrons) drop their animals off at the pasture and pick them up at the end of the season. Local associations determine the number of animals allowed for each patron, giving preference to those operators who are just starting out, those whose operations are financially marginal, and those who lack sufficient grazing land of their own. Grazing and breeding costs are recovered from the pasture patrons, while pasture conservation costs are “paid” by Canadian taxpayers. The largest portion of the costs of operating the pastures is recovered from patrons. During

1996-97, direct operating costs for the pastures were \$14.3 million, of which \$12.7 million was recovered. This was the only significant cost recovery activity by the Branch.

There are other opportunities to recover costs and generate additional revenue

24.77 The Prairie Farm Rehabilitation Administration provides a variety of technical assistance and financial services to producers, municipalities, and the Prairie provincial governments. Many of its programs provide a direct benefit to the program recipients. For example, providing technical assistance or funding for an irrigation system may add value to the land or increase the farmer's future revenues. While one could argue that the private benefit portion of this assistance should be recovered, what the farmer pays is a small portion of the overall cost.

24.78 Prairie Farm Rehabilitation Administration officials told us that at a time when other parts of the Department and the government were consulting with the agriculture sector on cost recovery, they had identified over \$ 0.7 million per year in possible cost recovery. There was a general understanding among service recipients that a portion of these costs should be recovered. The Prairie Farm Rehabilitation Administration applied to respend the costs it would recover, but this authority was not provided. In our view, this is not a sufficient reason to suspend cost recovery as a whole. It is also recognized that there will be administrative costs associated with recovering these costs. However, no analysis of the projected costs and returns has been done.

24.79 In areas it identifies for potential cost recovery, the Branch needs to determine what is a private benefit rather than a public benefit, and what portion of the private benefit should be recovered. To do this, it needs a sound basis of measurement for defining the costs and benefits: the Branch needs reliable data on which to base its costing decisions. Its current financial and program systems are not able to provide an appropriate basis for determining costs.

24.80 Cost recovery is more acceptable to users when "clients" of the services are involved in defining the cost components and determining the proportion of private benefit derived. Although the Prairie Farm Rehabilitation Administration consults with stakeholders about the implications of cost increases and service reductions, it needs first to determine the level of private benefit derived.

24.81 The Branch also has opportunities to generate additional revenues, such as the sale of surplus produce from the Saskatchewan Irrigation Development Centre. As part of its work at the Shelterbelt Centre, it conducts research into finding and developing species for the particular climatic conditions experienced in the Prairies. Advances in selective breeding have resulted in superior products. To date, the proprietary rights associated with these newly developed products have not been exercised, nor have the potential costs and returns of implementing these procedures been analyzed.

24.82 **As it continues to enhance its partnership with the agricultural sector, the Prairie Farm Rehabilitation Administration should identify the most cost-effective way to deliver its services and determine the optimum mix of cost recovery, cost sharing, and revenue generation.**

Department's response: The Department appreciates the Auditor General's recognition that progress has been made in PFRA's cost recovery efforts (particularly regarding the Community Pasture Program) and the recognition that PFRA consults with stakeholders on the implications of cost increases and service reductions.

PFRA accepts that there may be further revenue opportunities that could be pursued in consultation with industry. However, it should be noted that it is not obvious that it would be cost-effective to pursue all of those currently identified. PFRA will examine the feasibility of pursuing various opportunities and will continue to make progress on identifying the most cost-effective ways to deliver its services.

Performance Measurement

Absence of procedures to measure results of addressing soil and water problems

24.83 Generally accepted management practices stress the importance of measuring results. In particular, there is a need to measure the initial state and to measure again at regular intervals, in order to track the extent to which the desired change has occurred. The Treasury Board Secretariat has identified performance measurement and reporting as a central requirement of departmental Business Plans.

24.84 Developing indicators that are meaningful to end-users is not an easy task, as it is critical to develop either a reference value or, where that is not possible, a desired direction for change. As part of the new Department-wide Expenditure Management System, corporate departmental management has initiated the development of a planning, reporting and accountability structure intended to form the basis for seeking spending authority and for measuring performance. As part of this effort, the Prairie Farm Rehabilitation Administration is developing performance measurement systems to standardize what it measures and reports.

24.85 In most areas, Branch management has not yet developed the indicators or measurement procedures needed to determine the precise nature and magnitude of the soil and water problems in the Prairies, or to permit it to track the results of its interventions. We reviewed program evaluations conducted for the Prairie Farm Rehabilitation Administration by three different consulting firms. The evaluations consistently identified the absence of qualitative and quantifiable objectives; the absence of a performance measurement strategy to collect baseline information and report on the impacts of project funding; and lack of economic analysis to support the selection of projects or categories of projects.

24.86 Our interviews with district managers and regional directors confirmed that the Branch lacks performance indicators. It does not have a basis for determining how well a program has been delivered, nor can it measure the program's impact on the Prairie landscape. Decision makers continue to operate these programs with no continuing source of objective information about how well the Branch has delivered its mandate, except through comments from program recipients — a useful, but limited, form of performance measurement.

24.87 For example, one key problem the Prairie Farm Rehabilitation Administration is seeking to address is soil erosion. The 1997-98 Estimates Part III notes that Prairie Farm Rehabilitation Administration continues to protect over 3.5 million hectares of marginal and/or crop lands for the continued sustainability and productivity of the resource. Statistics like these need to be refined into an indicator by relating them to some measure — for example, comparison with the total number of hectares that require erosion control. This kind of interpretative framework is necessary if data are to become useful information for policy-making, planning and accountability purposes.

24.88 **The Prairie Farm Rehabilitation Administration should ensure that the performance measurement framework it is developing identifies performance objectives, indicators and results for activities ranging from the project level to the Prairie-wide context. Its progress in achieving desired results should be reported to Parliament in the Department's performance reports.**

Department's response: As noted, the Department is currently developing a comprehensive Performance Reporting and Accountability Structure. PFRA, as a Branch of the Department, is participating fully in this process. The PRAS was submitted to Treasury Board in the fall of 1997. The PRAS will provide a continuously improving basis for measuring and reporting on performance.

Conclusion

24.89 The Branch's extension of both its locations and its activities has taken place over a number of years while the organization's staff has been shrinking and decentralizing. In summary, the scope of the Prairie Farm Rehabilitation Administration's role takes in the Peace River District of British Columbia and most of the Prairie landscape, and has environmental, social and economic aspects. While the Branch has adapted to changing demands, its role is a large one for what has become a relatively small, decentralized organization.

24.90 The Prairie Farm Rehabilitation Administration's mandate, objectives and accountability framework are not sufficiently clear and complete to provide a basis for guiding activities; and the information needed to demonstrate results, including the achievement of program objectives, is not readily available.

24.91 We also concluded that this Branch could operate more effectively and efficiently if the needs for programs were better defined so that program activities could respond to the greatest needs. In addition, further steps need to be taken to improve the guiding and directing of activities.

24.92 While the Branch has undertaken steps to reduce costs, opportunities exist to reduce them further and to generate additional revenues.

About the Audit

Scope

The focus of our value-for-money audit was the Prairie Farm Rehabilitation Administration and the departmental lines of businesses for which it is accountable. Also included in the audit was the co-ordination of its programs and activities with those of other organizations in the Department, other federal departments and agencies, the provinces and industry.

The Western Grain Transition Payment Program was covered by our November 1995 Report and therefore was excluded from the scope of our examination. Given the diversity and number of the remaining programs delivered by the Branch, we selected for detailed audit those programs that:

- were operating in 1996-97;
- represent 20 percent of the A-Base budget (3 of 7 programs) plus 20 percent of the funding for sunset programs (3 of 10 sunset programs);
- are offered in all three Prairie provinces; and
- are integral to the business objectives of the Branch's mission statement.

The Department agreed that findings within the scope of this audit would be representative of the Prairie Farm Rehabilitation Administration's ongoing A-Base and sunset programs.

Objectives

Our objective was to assess the management practices related to rural Prairie sustainability and development with a view to determining whether specific areas require significant improvement. In particular, we assessed whether:

- the mandate, objectives and accountability framework are clear and complete for guiding activities, and the information to demonstrate results, including the achievement of program objectives, is readily available and reported to Parliament;
- program activities respond to identified needs, and satisfactory and cost-effective processes are in place to direct activities, guide project selection and guide contractual arrangements; and
- opportunities for cost avoidance, reduction or recovery have been adequately examined.

Criteria

Audit criteria are contained within the text.

Audit Team

Robert Anderson
Angus Mickle
Gordon Stock

For information, please contact Neil Maxwell, the responsible auditor.

Chapter 25

Citizenship and Immigration Canada and Immigration and Refugee Board

The Processing of Refugee Claims

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Citizenship and Immigration Canada and Immigration and Refugee Board

The Processing of Refugee Claims

Assistant Auditor General: Richard Flageole
Responsible Auditor: Serge Gaudet

Main Points

25.1 When it signed the *1951 United Nations Convention Relating to the Status of Refugees* and the *1967 Protocol* thereto, Canada undertook to protect refugees. The processing of refugee claims functions in a context characterized by intense and complex migratory movements. In addition, formal procedures must be followed and legal requirements taken into account in order to guarantee compliance with the provisions of the *Immigration Act* and Regulations and the *Canadian Charter of Rights and Freedoms*.

25.2 At the end of 1988, the process had developed a backlog of some 85,000 claims. The system was not up to the task and a radical change was needed. A new structure and a completely revised process for handling claims was put into place in 1989. The expectations were clear: quick, equitable and efficient resolution of claims and the removal of failed claimants.

25.3 We note, however, that Citizenship and Immigration Canada and the Immigration and Refugee Board have serious difficulties dealing with claims quickly and efficiently. We are particularly concerned by the size of the backlog, the lengthy processing times and the difficulty of carrying out removals. We have made recommendations aimed at improving results at various stages in the process.

25.4 Immigration officers rule on the eligibility of a claim without having obtained the required information. Moreover, the information gathered when the claim is received does not serve adequately at other stages in the process.

25.5 The high turnover among members of the Immigration and Refugee Board, and their short terms, have a significant negative impact on achieving targeted results. Moreover, lack of rigour in certain practices slows down the process. The Board has made efforts to improve the process but their success will depend in part on the Board's ability to improve its organizational climate.

25.6 Citizenship and Immigration Canada is having difficulties resolving failed refugee claims quickly and efficiently. The review of risk of return contains ambiguities that raise questions about its merit. We also found a lack of rigour in the assessment of humanitarian grounds for allowing failed claimants to remain. Further, the Department is having serious difficulties carrying out removals.

25.7 Refugee-related questions are complex. A thorough review of the refugee claim process is required — including the division of roles and responsibilities among the various stakeholders as well as the infrastructure of co-ordination and control. However, it is essential that realistic expectations be set for the speed and efficiency of claims processing.

Introduction

The protection of refugees — an important international commitment

25.8 In 1969, Canada signed the *1951 United Nations Convention Relating to the Status of Refugees* and the *1967 Protocol* thereto. In so doing, it undertook to protect refugees who find themselves outside their country and are unable to return to it for fear of persecution because of race, religion, nationality, membership in a particular social group or political opinion. Under the Convention, Canada thus undertook not to expel or turn back refugees at the border if doing so would threaten their lives or freedom.

25.9 Canadian immigration rules, including those that apply to refugees, are contained in the *1976 Immigration Act* and its related rules and regulations. The Act reiterates Canada's international commitments with respect to the protection of refugees, repeats the definition of the term "refugee" as set out in the Convention and provides rules for the processing of claims for refugee status.

25.10 The Convention governs primarily the situation of persons who have fled their own country and are claiming refugee status in another country. As part of its humanitarian tradition, Canada also selects refugees abroad. However, our audit dealt only with those claimants seeking protection after arriving in Canada.

Migratory movements are intense and complex

25.11 Internationally, the circumstances and origins of persons seeking asylum are in a constant state of flux. Ever-increasing numbers of people are fleeing ethnic, political and religious conflict. In 1995, the United Nations High Commissioner for Refugees estimated that 14.5 million refugees crossed an international border and received asylum in another country. The examples of this are many and varied: recent crises in the former Yugoslavia, Somalia, and Rwanda, to name only a few, have resulted in significant movements of people.

25.12 Many other persons are attempting to escape problems such as overpopulation or a fragile economic situation in their home country. Communication and transportation networks have increased their expectations and possibilities. One recent example is that of many Chileans who, in the false hope of improving their lot, came to Canada in 1995.

25.13 In addition, there are professional traffickers and agents whose aim is to have their clients arrive and remain in their chosen country. The increasing complexity of migrations creates challenges for the receiving countries, who must grant protection to the refugees while safeguarding the interests of their own nationals and the integrity of their immigration programs.

25.14 Exhibit 25.1 shows the number of claims filed in various industrialized nations, including Canada, since 1983. During that time, major backlogs have developed in several countries, such as the United Kingdom, the United States and Canada. A number of industrialized countries are concerned with efficiency and effectiveness issues in their processes for handling requests for asylum. Some, including the United States and the Netherlands, have substantially increased staff in the hope of reducing backlogs and abuses of the system. In 1996, close to 26,000 persons claimed refugee status in Canada. Exhibit 25.2 shows the 10 principal countries of origin of these claimants.

Exhibit 25.1

(This exhibit is not available, see the Report)

Exhibit 25.2

(This exhibit is not available, see the Report)

The Canadian Charter of Rights and Freedoms has a major impact on the process

25.15 The Supreme Court of Canada decided that the guarantees set out in section 7 of the *Canadian Charter of Rights and Freedoms* (namely, that everyone is entitled to life, liberty and security) apply not only to Canadian citizens, permanent residents or other persons legally in Canada but to every person within Canada's borders. Further, the Supreme Court decided that any claim having a minimum credible basis for refugee status must be heard when the basis for it is seriously in doubt.

25.16 Under the *Charter*, additional rights are available to everyone who is present in Canada — the right not to be detained without just cause; the right, upon arrest or detention, to be informed promptly of the reasons; the right to retain and instruct counsel without delay; and the right to challenge detention by “habeas corpus”. The refugee status determination process must ensure that refugee claimants are afforded all the rights provided to them by the *Charter*.

Claims processing: a shared responsibility

25.17 The Department of Citizenship and Immigration (the Department) administers the *Immigration Act*; it therefore must manage admissions to Canada in a way that safeguards the interests of Canadians while fulfilling Canada's international commitments. Claimants' cases are processed mainly at the Department's Canadian offices — at border points, inland immigration offices and processing centres. Deciding whether or not a claimant is really a refugee under the Convention is the responsibility of the Immigration and Refugee Board (the Board).

25.18 **A quasi-judicial process.** The *Immigration Act* stipulates that claims are to be heard by the Convention Refugee Determination Division of the Immigration and Refugee Board. This Division is an administrative tribunal with inquiry powers. The claimant can request leave of the Federal Court for a judicial review of the Division's ruling. Formal procedures must therefore be followed that take into account the legal requirements of the refugee status determination process in order to guarantee compliance with the provisions of the *Immigration Act* and Regulations and the *Charter*.

25.19 Exhibit 25.3 provides a summary of the principal steps in the refugee claims process. When a claim is received, a senior immigration officer of the Department determines whether the claimant is eligible under the *Immigration Act* for access to the refugee determination system. If so, the claim is referred to the Board, which considers the claim at a hearing and determines whether the claimant is a Convention refugee. If granted refugee status, claimants may apply for permanent residence. If their claims are denied, they may avoid removal if the Department considers that, under the Post-Determination Refugee Claimants in Canada Class (see paragraph 25.117), they would still be at serious risk if they returned to their home country. Claimants may also apply at any time for permanent residence on humanitarian and compassionate grounds. Failed refugee claimants will ultimately have to leave Canada although those awaiting removal for several years could, until 1997, be eligible for permanent residence. There is no mechanism to appeal the merit of the decisions rendered by the Convention Refugee Determination Division of the Board. However, the various decisions throughout the process may be subject to judicial review by the Federal Court.

Exhibit 25.3

(This exhibit is not available, see the Report)

25.20 Although the Department and the Board are the principal players in the decision-making process, other stakeholders are involved, such as the RCMP, the Canadian Security Intelligence Service (CSIS) and the Department of Justice.

25.21 Current practice dictates that from the time claimants arrive in Canada, and for as long as they remain and their claim is making its way through the process, they qualify for many of the benefits granted to landed immigrants, such as social assistance, legal aid, education and health care. The provinces, in administering these benefits, thus have some influence on refugee-related issues.

25.22 The complexity of the process that claims must follow, given the number of parties involved, means that the total processing costs cannot be measured easily. In fact, the Department was unable to provide us with a reasonable estimate of the overall cost of the process. However, the fragmentary data available indicate that the cost to the federal government is at least \$100 million a year. In addition, data from Ontario and Quebec — the provinces receiving the majority of claimants — show that it costs each of them approximately \$100 million a year just for social assistance to claimants.

The claims processing system has undergone major changes since 1989

25.23 At the end of 1988, the Canadian refugee status determination process had developed a backlog of some 85,000 claims. Because of the slow pace of the process, a refugee status claim was tantamount to a permit to stay in the country for at least three years and even to settle here permanently. All claimants then had access to a complex process of review and appeal.

25.24 Employment and Immigration Canada, the department responsible for the program at the time, believed that the process was not up to the task and that it did not include any mechanisms for quickly and decisively settling claims that clearly lacked merit. A radical change to the system was needed.

25.25 On 1 January 1989, Bill C-55 amending the *Immigration Act* came into effect, putting into place a new structure and a completely revised process for handling claims made after that date. The process would henceforth fall under the joint responsibility of Employment and Immigration Canada (the Department of Citizenship and Immigration was not established until 1994) and a new body — the Immigration and Refugee Board, which was given the power to rule on the merit of claims. A program implemented at the Department to clear up the backlog allowed for separate handling of the some 85,000 cases accumulated under the previous system.

25.26 The legislative changes were designed to streamline the processing of claims, provide protection for individuals who were genuinely threatened in their country of origin, and discourage those not requiring the protection of Canada or whose claims were unfounded. The expectations were clear — quick, equitable and efficient resolution of claims and the removal of failed claimants.

25.27 Shortly after the new process was implemented, the concerns it had been designed to resolve resurfaced. Our 1990 audit of the system noted that after just 15 months, the process was already seriously behind schedule. In fact, at 31 March 1990, there was a backlog of 23,500 claims or 71 percent of all claims received. It took an average of nine months to process a claim. We also noted that 95 percent of claimants whose claims had been denied were still in the country. Further, we expressed concern about some of the operating mechanisms used by the Board and the Department.

25.28 Subsequently, two major bills (C-86 in 1993 and C-44 in 1995) and a number of regulatory changes gave rise to a series of measures designed to improve the situation. Specific aspects of these changes are discussed in the related sections of this chapter.

Focus of the audit

25.29 Our audit focussed primarily on determining whether the management mechanisms used by the Department and the Board allow for a quick and equitable resolution of refugee status claims and foster public confidence in the fairness and integrity of the process. Additional information on the objective and scope of the audit can be found at the end of this chapter in the section entitled **About the Audit**.

Observations and Recommendations

The Federal Government Has Serious Problems Handling Refugee Claims Quickly and Efficiently

Results have been disappointing and the concerns remain

25.30 We note that the existing system has serious difficulty dealing with claims quickly and efficiently. Exhibit 25.4 provides statistical data on volumes, processing times and decisions in the past four years. Exhibit 25.5 shows the status of persons who have made claims between February 1993 and March 1997.

Exhibit 25.4

Statistical Data

Statistics on volumes

	1993-94	1994-95	1995-96	1996-97
Claims received by CIC	19,456	23,118	26,917	23,999
Claims finalized at the IRB	31 886	21 700	17 811	23,253
Backlogs at the IRB ¹	17,528	19,523	28,588	28,893
Risk-of-return review backlogs (CIC) ¹	n/a	16,814	10,214	8,527
Number of removals confirmed to CIC ²	4,611	2,698	1,547	2,465

Statistics on processing times

	1993-94	1994-95	1995-96	1996-97
Average processing time at the IRB (months)	7.0	8.7	10.6	12.8
Age of pending cases at the IRB				
0-1 year	14,311	16,120	21,893	18,783
1-2 years	2,655	2,635	5,572	8,547
2 years and up	562	768	1,123	1,563
Average processing time (months) between the IRB decision and the risk-of-return review decision at CIC ²	14	11	10	7

Statistics on decisions

	1993-94	1994-95	1995-96	1996-97
% of claims deemed eligible by CIC ²	99.5	99.3	99.5	99.4
% of favourable IRB decisions	48	62	54	41
% of withdrawals and abandonments at the IRB	20	18	23	29
% of positive risk-of-return review (CIC)		16	6	4

¹ At the end of the period

² Calendar years: 1993 to 1996

Source: Immigration and Refugee Board and Citizenship and Immigration Canada

Exhibit 25.5

(This exhibit is not available, see the Report)

25.31 We are especially concerned by the size of the backlog, the lengthy processing times at the Board and at the Department, and the limitations on control and enforcement activities — primarily the difficulty of carrying out removals. These concerns are essentially the same as were meant to be addressed almost 10 years ago with the introduction of the current system.

25.32 The size of the backlog is particularly disturbing. Exhibit 25.6 shows that numbers of claims awaiting processing at the Board have almost doubled since June 1994, even though the number of claims referred has remained fairly constant. At 31 March 1997, the Board's inventory of cases not yet finalized had risen to close to 29,000. In addition, there were approximately 8,500 cases at the Department awaiting its review of the risk to the claimants should they be removed from Canada.

Exhibit 25.6

(This exhibit is not available, see the Report)

25.33 With respect to processing times, we noted that in 1996-97, the average interval between the filing of a claim and the Board's decision was 13 months. Although data on processing times at each stage in the process are not available at the Department, we estimate that the interval between the Board's decision and the Department's reassessment based on the risk of return was almost 7 months, with another 10 months before the removal. Judicial review by the Federal Court accounts for part of these delays. A person claiming refugee status can therefore count on staying in Canada for more than two and a half years.

25.34 The issue of removals also warrants particular attention. Of the approximately 31,200 claimants who were denied refugee status between 1993 and 1997 or were not otherwise accepted in Canada, 22 percent have confirmed their departure from Canada. We estimate that those who have not left have been in Canada for two and a half years, on average.

25.35 Several factors contribute to the problems of the current system. We noted problems of efficiency and operational effectiveness and a lack of rigour at various stages in the process, which have had a serious impact on the system's ability to meet expectations. However, we also noted weaknesses that pervade the entire process — a lack of co-ordination, integration, strategic direction and overall follow-up.

25.36 Departmental officials at ports of entry, immigration centres and various processing units all examine a claimant's case at some point. In the midst of this process, the Board assesses the merit of the claim. Further, some

cases require the involvement of the Federal Court, the Department of Justice, the RCMP or CSIS. While all this is taking place, no one in the federal government monitors the overall progress of claims.

25.37 During the course of our audit, we had to consult many stakeholders and decision makers to be able to identify priorities and strategies in refugee-related issues. These consultations gave us a picture of specific activities in the process but not of the way they are linked. Nor did we perceive any collective effort to make the decision-making process quicker and more efficient. The lack of global knowledge and management of refugee-related issues limits the possibility of processing claims quickly and efficiently.

25.38 Given this situation, we had to delve into various information systems in the Department's and the Board's head offices and regional directorates and offices for the data we needed to piece together an overall picture of refugee-related activities, to measure processing times and pending cases and to attempt to quantify total costs. The Department's information systems could not compile the information needed to account for the resources used in processing refugee claims. We also noted that the availability and quality of information on claims gradually begin to deteriorate once failed claimants begin the long and complex series of activities related to additional reviews and to removals. We found that the Department's information systems contained a significant number of unresolved cases.

Receiving Claims

Determining eligibility: an essential control but ineffective

25.39 Determining the eligibility of a refugee claim is very important, since it controls access to the refugee determination system and access to Canada.

25.40 The *Immigration Act* sets out the circumstances that make a refugee claim ineligible, meaning that it cannot be referred to the Convention Refugee Determination Division of the Immigration and Refugee Board for a hearing. The aim of the *Act* is to quickly exclude from the process those persons who do not deserve or need Canada's protection. These include dangerous criminals, persons who have already been granted refugee status in another country, terrorists and war criminals, and those who have been denied refugee status in Canada within the previous 90 days. It is noteworthy that determination of eligibility is not designed to assess the merit of a refugee claim.

25.41 Of the nearly 26,000 refugee claims made in Canada in 1996, 60 percent were made at border points and the remainder at immigration offices inland. It should be noted that the Ontario and Quebec regions received 88 percent of all claims. Exhibit 25.7 provides a breakdown of claims received; we note that claims from the 10 major offices and border points in Canada account for 89 percent of all claims.

Exhibit 25.7

Main Locations in Canada Where Claims Were Made in 1996

Montreal (Quebec)	Inland office	4,310
Mirabel (Quebec)	Airport	3,681
Toronto - Pearson (Ontario)	Airport	3,367
Lacolle - Blackpool (Quebec)	Border point	2,845
Etobicoke (Ontario)	Inland office	2,736
Fort Erie (Ontario)	Border point	2,036
Vancouver Metro (B.C.)	Inland office	1,206

Vancouver (B.C.)	Airport	1,060
Dorval (Quebec)	Airport	783
Niagara Falls - Rainbow (Ontario)	Border point	753
Total		22,777
Canada		25,697
Percentage		89%

Source : Field Operations Support System (FOSS) of CIC

25.42 When an individual claims refugee status, senior immigration officers question the individual, often with the aid of an interpreter, and ask him or her to complete a personal identification document; they then examine all available relevant documentation, such as passports, identification or travel documents. The officers also take fingerprints and a photograph of the claimant. The fingerprints are forwarded by mail to the Royal Canadian Mounted Police (RCMP) to check whether there is another claim on file with the same fingerprints and whether the claimant has a criminal record in Canada. In the vast majority of cases — over 99 percent since 1993 — the claim is judged eligible. The immigration officers then complete the administrative procedures, provide the person with the necessary documentation for filing a claim with the Board, and allow the person to enter Canada.

25.43 We noted that in most cases, immigration officers rule on the eligibility of a claim without first obtaining the information required to make an informed decision. In fact, the evaluation of eligibility criteria is based essentially on the claimant's statement. Immigration officers render their decisions well before receiving the results of the RCMP checks for duplicate claims and a criminal record in Canada.

25.44 In order to determine the eligibility of a claim, the claimant's background in Canada and abroad need to be known. This requires at the outset a minimum of information on the claimant. Our audit revealed that over the past several years, close to 60 percent of claimants have presented themselves to Canadian officials without a passport, personal identification or travel documents.

25.45 It is understandable that someone fleeing persecution may arrive destitute, lacking even personal documents. However, it is reasonable to expect that they would have travel documents, because the *Immigration Act* requires airlines to ensure that their passengers are properly documented. We believe the Department needs to make additional efforts to determine claimants' origins.

25.46 In our view, then, the Department does not examine claims with sufficient rigour to establish whether eligibility criteria are met. This allows people access to the refugee determination process and to Canada without it being known whether their claims warrant an in-depth review.

25.47 **Citizenship and Immigration Canada should review the mechanisms used in the application of the eligibility criteria set out in the *Immigration Act*.**

Department's response: The eligibility criteria are intended to prevent exceptional cases from proceeding to the full process of refugee determination. In all cases, where there is information that a claimant does not meet the eligibility criteria, the person is found to be ineligible and the claim is not referred to the Immigration and Refugee Board. Once fingerprint results are received, the legislation allows for the eligibility decision to be revised where necessary.

Recently, the Department has increased efforts to determine the routing and identity of passengers arriving without documents by increasing the frequency of document inspections at the point of disembarkation from aircraft.

More complete, more relevant information needs to be gathered during the initial contact with the claimant

25.48 Good quality of information on a claimant's identity and on the particular circumstances of the claim — such as the country of origin, the reasons for the claim, and the last point of embarkation — is essential to informed decision-making at all steps in processing the claim. One would therefore expect sufficient co-ordination and integration among the steps in the process to provide for optimum sharing of the necessary information.

25.49 In June 1995, the Department and the Board agreed that the information collected by immigration officers upon receipt of a claim would systematically be sent to the Board. This information is useful because it can help Board members later to verify the claimant's identity and credibility. Implementing this agreement yielded good results until the Department began changing its practices at ports of entry in the fall of 1996. Under these changes, claimants at some ports of entry are virtually never questioned about the circumstances of their claims and are asked only to fill out the information forms. The information thus gathered when the claim is received is not as useful as it could be.

25.50 Despite serious objections raised about the relevance and the probative value of the information thus gathered, Board members and refugee claim officers clearly indicated to us that the notes taken at ports of entry enhance the quality of the Board's decision. In a situation where 60 percent of the claimants have no identification papers or travel documents, the Board member must be able to rely on the maximum information possible to help verify the claimant's identity and credibility.

25.51 **Citizenship and Immigration Canada and the Immigration and Refugee Board should co-operate to establish a common strategy for ensuring that all information relevant to the processing of refugee status claims is collected in a timely fashion.**

Department's response: Agree. The Immigration and Refugee Board and the Department have agreed to analyze the needs of the tribunal for information from the ports of entry and review the practices at ports of entry.

Board's response: Agreed. The Board views as essential the gathering of information relevant to the processing of refugee status claims and confirms its commitment to increased co-ordination with the Department to this end. The recent Administrative Framework Agreement concluded between the Board and the Department has already laid the groundwork for significant progress in this field. Co-ordination efforts are continuing in order to achieve greater efficiency in the process and improved quality in the decisions rendered.

Provision to process claims in the first country of asylum has never been applied

25.52 The majority of persons claiming refugee status at ports of entry in Canada arrive from a country other than the one where they may be subject to persecution. In the first five months of 1997, for instance, more than half the claims at ports of entry were made by individuals arriving from the United States.

25.53 When the process was completely restructured in 1989, Parliament included a particularly important provision designed to safeguard our system against an influx of claimants who did not require Canada's protection. Under the "safe third country" provision, the Department and the Board could deny access to the refugee status determination process by claimants arriving from countries known to respect human rights. The claimant had the right to appeal the decision, but would have to wait outside Canada. At the time, the Department projected that approximately 40 percent of claimants would be sent to a "safe third country" after an initial quick hearing. That provision has never been applied.

25.54 Changes made to the *Immigration Act* in 1993 allow Canada to also enter into agreements with certain countries who are signatories to the Convention to share responsibility for examining refugee claims. In principle, such agreements would mean that claimants would request the protection of the first country in which they found

asylum, rather than simply entering that country on their way to their preferred country. The Department indicated that such agreements would foster better compliance with the rules governing the refugee determination process by discouraging “asylum shoppers”.

25.55 In February 1995, Canada and the United States entered into negotiations to decide who would take responsibility for persons entering one country and claiming refugee status in the other. However, the agreement has not yet been finalized.

25.56 **Citizenship and Immigration Canada should intensify its efforts to ensure an increased level of international co-operation with respect to responsibility for the review of refugee claims.**

Department's response: Agree. The conclusion of broad framework agreements on responsibility sharing for refugee claims remains an important element of Canadian asylum policy. This is particularly important for Canada in a regional context given the significant numbers of claimants who arrive via the United States. This policy objective is reflected in the Border Accord between Canada and the United States announced in February 1995. Discussions with the United States continue in pursuit of active co-operation on this issue.

Determination of Refugee Status at the Board

25.57 The Immigration and Refugee Board is an organization that has been given a difficult mission, requiring that it make sensitive decisions within a complex operating environment. The Board's mission is, on behalf of Canadians, “to make decisions on immigration and refugee matters reasonably, efficiently, fairly, and in accordance with the law”. The mandate of the Convention Refugee Determination Division is primarily to determine whether a claimant meets the definition of refugee under the Convention. Against this background, the need for protection takes on a narrow meaning — specifically, the one set out in the Convention.

25.58 Refugee status is determined through a hearing into the claimant's circumstances to determine whether there is a serious likelihood that he will be persecuted if he returns to his home country. The role of a Board member differs procedurally from that of a judge in a court. The Board is a specialized tribunal invested with inquiry powers and using a non-adversarial procedure. The primary objective of such a procedure is to elicit all the relevant information needed to arrive at an informed decision. The hearing is generally held before a panel of two Board members, a refugee claim officer who is a Board employee, and the claimant, normally represented by counsel. Where necessary, the Board provides the services of an interpreter. The granting of refugee status requires the approval of one of the two Board members.

25.59 The heavy workload generates pressure to improve performance. At the same time, the non-adversarial hearing takes place in a context where the very nature of the claim poses major challenges of availability and quality of information on the circumstances of the claim. While in theory the burden of proof is on the claimant, Canada has decided to give claimants the benefit of the doubt, thereby following the recommendation of the United Nations High Commissioner for Refugees.

25.60 Over the past three years the Board has not been able to achieve its objectives for processing times. The average processing time went from seven months in 1993-94 to nearly 13 months in 1996-97. The same period also saw a sharp increase in the backlog of claims waiting to be processed, from approximately 17,500 at 31 March 1994 to nearly 29,000 at 31 March 1997. At that date, more than 10,000 claims had been awaiting processing for over a year. However, we have observed a slight decrease in the backlogs since January 1997.

Efforts to improve the selection process for Board members need to be continued

25.61 Board members must make complex decisions that could have a major impact on the life, liberty or security of the claimant and on the integrity of the system — an impact that makes their role akin to that of a court judge. There must never be any doubt about their competence or their independence. It is therefore essential that the selection of Board members be based on merit and that the selection process be transparent.

25.62 The *Immigration Act* stipulates that members of the Convention Refugee Determination Division of the Board be appointed by the Governor in Council. After a number of concerns were expressed about the lack of qualitative criteria and transparent mechanisms governing the appointment of Board members and the renewal of their terms, in March 1995 the Minister of Citizenship and Immigration announced the establishment of an advisory committee to assist in the selection of Board members. The objective of this committee is to strengthen the independence of the Board and the transparency of the selection process while raising the level of Board members’ qualifications.

25.63 The selection criteria are defined by the Minister, and calls for candidates are made through an announcement in the *Canada Gazette*. Exhibit 25.8 sets out the requirements for the position, as described in the two calls made since 1993.

Exhibit 25.8

Job Requirements for Members of the Board

Canada Gazette 18 September 1993	Canada Gazette 23 August 1997
<ul style="list-style-type: none"> • knowledge of social sciences and/or community-based experience in immigration or refugee affairs • ability to conduct a quasi-judicial hearing • ability to carry a heavy workload and perform in a sometimes stressful environment • excellent analytical and writing skills • strong communication and interpersonal skills <p>The following are considered an asset:</p> <ul style="list-style-type: none"> • an understanding of cross-cultural issues and of the global situation of refugees • member of the bar of any province or territory or notaries with the <i>Chambre des notaires du Québec</i> who has at least five years of experience 	<ul style="list-style-type: none"> • university degree or equivalent professional qualification • a minimum of five years of professional experience following graduation • ability to demonstrate decisiveness and sound judgment in an environment of high case volume and tight time constraints • strong listening and analytical skills • effective spoken and written communication skills <p>The following are considered an asset:</p> <ul style="list-style-type: none"> • knowledge of the Canadian immigration program • cross-cultural and social program experience • experience in executive decision making in a corporate, government or legal environment • computer literacy and initiative to excel in their field of expertise • bilingualism (French and English) • knowledge of a third language

Source: Canada Gazette

25.64 The advisory committee was given a mandate to assess candidates for the position of Board member and to submit a list of qualified candidates to the Minister. It is expected that, based on that list, the Minister would then select candidates to recommend to the Governor in Council.

25.65 In our view, the establishment of this committee is a step in the right direction, allowing for the selection of qualified candidates. However, we noted weaknesses in the candidate selection process that make it difficult to ensure that the most highly qualified candidates for the position of Board member are identified.

25.66 First, we feel there is a need to improve the recruitment methods in order to attract the most highly qualified candidates. Most of the applications examined by the advisory committee between 1995 and 1997 resulted from an advertisement published in September 1993. Candidates were therefore assessed, in many cases, on the basis of information that was more than two years old. In our view, calls for applicants need to be made more regularly, using various vehicles.

25.67 We noted that the screening tools developed by the committee are not entirely appropriate for evaluating the applicants according to the established criteria. We were told that the advisory committee has already begun to review its evaluation tools.

25.68 Further, there are no mechanisms in place to ensure consistency in the interpretation and application of criteria. Because of their heavy workload, the members of the committee decided to divide up the task of assessing the applications. Each member individually evaluated a certain number of applications and orally informed the entire committee which candidates he or she would suggest putting forward to the Minister. The evaluations of the candidates were not recorded and no documentation in support of them was provided to the other committee members. We do not think this type of evaluation provides for the same rigour and validity as an evaluation of candidates by the full committee.

25.69 The advisory committee is also responsible for recommending to the Minister which Board members' terms should be renewed. We noted that it had little information at its disposal to carry out this task. In effect, the committee's decision is based primarily on the overall results of performance appraisals. Our review of the performance appraisals of 68 Board members whose terms expired between January 1996 and May 1997 showed that they had all been evaluated as "meets expectations", whether or not their terms were subsequently renewed.

25.70 **The government should ensure that the selection process for Board members provides greater certainty that appointments or reappointments to the Immigration and Refugee Board are based on the qualifications needed to respond to the complexity and the importance of the task.**

High turnover among members and short terms have a significant negative impact on productivity

25.71 The refugee status determination process requires a special expertise that can be acquired only through experience or, to a lesser degree, through training. Most Board members agree that a minimum of 12 months is needed to become completely functional. Given this and the importance of the decisions they are required to make, we expected to find an organization staffed at all times with a large percentage of experienced decision makers.

25.72 Since its establishment in 1989, the Board has undergone periods of high instability. Approximately 420 persons have been appointed by order-in-council to the Convention Refugee Determination Division and 40 percent of them were given only one term, generally for a period of approximately two years. The average rate of reappointment between 1990 and 1993 was 79 percent. This figure fell to 25 percent between 1994 and 1996. Exhibit 25.9 shows the fluctuations in the rates of reappointment.

Exhibit 25.9

(This exhibit is not available, see the Report)

25.73 More than 170 members have left the Board since 1994, leaving it with a large number of inexperienced members. Such a high turnover rate is bound to affect the quality of decisions.

25.74 Although many factors can affect a Board member’s productivity, we feel that the high rate of turnover has had a particularly negative impact. As shown in Exhibit 25.10, the average number of cases finalized quarterly per Board member fell dramatically in 1994, when 126 terms expired and only 24 were renewed. The Board estimates that a Board member’s rate of productivity in the first year is approximately 50 percent.

Exhibit 25.10

(This exhibit is not available, see the Report)

25.75 Besides affecting productivity, a high turnover rate represents additional expenses for training and relocation. The Board estimates that appointing someone new costs, on average, \$91,700 more than renewing the term of an experienced Board member.

25.76 In our view, the length of the term needs to be related first and foremost to the requirements of the position. Provision is made in the *Immigration Act* for terms of up to seven years. Since 1994, however, most new Board members have been appointed for periods of two to three years (see Exhibit 25.11).

Exhibit 25.11

Length of Board Members’ Terms

Length	Appointments	Reappointments	
	1994 to 1997	1994 to 1996	1997
0-1 year	5	5	4
1-2 years	38	34	13
2-3 years	89	3	15
3-4 years	1	6	14
4-5 years	1	2	9
5-6 years	1	0	0
Total	135	50	55
Average	2.7	2.3	3.1

Source: Based on data of the Privy Council Office and the Immigration and Refugee Board

25.77 Members’ terms are renewable; in fact, 12 percent of members currently at the Board are completing their fourth or fifth term. Contrary to our expectation, we noted that the average length of a renewed term has been shorter than the initial term. In the 50 reappointments made between 1994 and 1996, the average term length was 2.3 years. This has increased to 3.1 years in 1997. The length of a term impacts on the Board member’s productivity: the vast majority of members consulted told us that the uncertainty characterizing the period before the renewal of their terms had had major negative implications for not only their morale but also their productivity.

25.78 A short term can produce other negative consequences. First, the names of individuals appointed to short terms must be submitted more frequently to the government for consideration of reappointment. This could threaten their independence or appear to do so. Also, the short length of terms could limit the government’s ability to attract qualified candidates. Finally, many of the Board members consulted said that fully satisfactory or even above-average performance is no guarantee of reappointment. In such circumstances, it is very difficult to develop a sense

of belonging or a climate of confidence in an organization, and to project a competent and independent image likely to foster public confidence.

Having available the decision makers as needed is important

25.79 It is important that the Board have the number of decision makers it needs to handle its workload and that its resources be allocated among regions on the basis of the specific needs in each.

25.80 We noted that the delays in filling positions have contributed to the problems encountered by the Board over the past several years. In April 1996, when the Board had 156 members, it agreed with the Minister's office that 182 members (including deputy chairperson, assistant deputy chairpersons and co-ordinators) were needed to meet the demand. At 1 September 1997, there were 154 members. We estimate that some 2,000 hearings could not be held during this period because of the delay in appointing members. Overall, the number of working members since 1994 has decreased, while the number of cases referred to the Board rose between 1994 and 1995 and has remained relatively stable since then.

25.81 We also found a number of anomalies in the distribution of members among the various regions in Canada. As shown in Exhibit 25.12, the proportion of members assigned to the Montreal and Toronto regions in the past three years does not correspond to the proportion of cases referred to the Board in these same regions. In the third quarter of 1995, there was a sharp increase in the number of cases referred in the Montreal region, lasting until the third quarter of 1996. The region could not handle this workload despite measures taken to improve its productivity. Although a request was made to have 22 additional members appointed to the Montreal office (10 full-time and 12 part-time), only 8 were finally appointed, 5 of whom were part-time.

Exhibit 25.12

(This exhibit is not available, see the Report)

25.82 The government has planned since March 1995 to amend the *Immigration Act* to allow most hearings to be held by one Board member instead of two. Claim-processing projections for 1996-97 were in fact made on the assumption that this change would be made before January 1997. Given that it was not, productivity was below projections and delays continued to increase.

25.83 Overall, the turnover rate among members, the length of their terms and the delays in appointments clearly affect the Board's ability to manage its workload and to attain its operational objectives; this translates into increased backlogs and processing delays.

25.84 **The government should improve its practices for appointing Board members, in order to ensure that the Immigration and Refugee Board has a sufficient number of experienced decision makers available when they are needed.**

The Board places great importance on maintaining and developing the skills of its members

25.85 In order to facilitate informed decision making, the Board needs to develop and maintain the skills of its members. As we have noted, terms are short, the turnover rate is high, and new members require at least 12 months to learn their job. In light of these factors, the mechanisms for developing and maintaining the skills of Board members need to be particularly effective in order to accelerate the acquisition of knowledge and to quickly identify the areas of performance that warrant special attention.

25.86 We noted that the Board places great importance on the training of its members and provides a complete training program. This program includes training for new members, ongoing professional development and information workshops. Most members indicated that they were satisfied with the training offered to them.

25.87 Performance management is also very important because it allows Board members to be monitored and to improve their performance without having the quality of their decisions questioned. In March 1995, a new performance appraisal system for members was implemented. We noted that performance appraisals are completed in the vast majority of cases. However, certain changes need to be made to this system in order to define and communicate performance expectations and objectives, and to make evaluation criteria more specific. In fact, the Board is currently reviewing its performance appraisal process.

The information available does not always foster informed and equitable decisions

25.88 Informed decision making depends on the quality of the information available. Members must be very familiar with conditions in the claimant's country of origin, as well as the specific circumstances justifying the claim. Further, members must consider the case law in order to ensure fair decision making.

25.89 Understanding the prevailing conditions in a country is vital to assessing a claim. The Board's Documentation, Information and Research Branch makes available to Board members a variety of reports and publications on conditions in the countries of origin of claimants, as well as on issues related to human rights in those countries. The sources used in preparing these documents include organizations for the defence of human rights. However, the different sources do not always agree on what conditions actually prevail in the countries. Board members are then required to judge those opinions in the light of their experience and the specific circumstances surrounding the claim. The establishment of teams that specialize in certain geographical areas makes it easier for Board members and refugee claim officers to master the massive amounts of information they must absorb to process claims effectively and fairly. Most Board members and officers feel that this step contributes greatly to the quality of their decisions.

25.90 The quality of information on the identity and particular circumstances of claimants is one more essential element of informed decision making. As mentioned in paragraph 25.49, the Department gathers little information on the circumstances surrounding claims, and a large number of claimants do not have the required identification documents. In these circumstances, it is very difficult for Board members to assess a claimant's identity and credibility. However, the Board recently implemented measures to address the problem of claimants who are not properly documented. For example, in March 1997 it published a document entitled *Commentary on Undocumented and Improperly Documented Claimants*, the purpose of which is to simplify the task of Board members as they examine issues of evidence and procedure that arise in these types of claims.

25.91 The Board also developed measures to allow for specific research on claimants. A new policy was established to clarify the type of research that may be done and the measures to take to avoid jeopardizing the lives of claimants or their families. Board members and refugee claim officers also feel that these steps have improved the quality of decisions. Because of the delays such research can entail, however, it cannot be used as often as is desirable.

25.92 The *Immigration Act* allows the Department to intervene at Board hearings. This intervention can be important in certain situations because the *Act* allows the Department's representative to submit evidence, question claimants or witnesses and offer observations. We noted that the Department rarely intervenes in hearings — in less than 2 percent of the cases finalized in 1996.

25.93 The *Immigration Act* gives the Board's Chairperson the authority to issue guidelines. Decision makers are not bound by these guidelines, but they constitute a recommended approach to reviewing difficult issues. For example, there are the *Guidelines Concerning Women Refugee Claimants Fearing Gender-Related Persecution*.

Legal Services also provides Board members with an array of information and tools to assist in their decisions. There is, for example, all the case law that stems from Federal Court rulings, as well as a monthly publication of a sample of Board decisions. However, the members indicated that they would appreciate being better informed of the reasons behind the favourable decisions as well as the unfavourable decisions of their colleagues; the *Immigration Act* requires only that unfavourable decisions be justified.

25.94 Despite all these efforts, there are major discrepancies among certain Board offices in acceptance rates for claimants from the same country. For example, in 1996 the acceptance rate for claimants from a certain country was 4 percent in one regional office and 49 percent and 82 percent in two others. For another country the acceptance rate at these same offices was 39 percent, 70 percent and 85 percent respectively.

25.95 The Board examined the discrepancies in the acceptance rates and concluded that a major contributing factor was that decision makers did not always use the same sources of information and interpreted the available information differently.

25.96 The Board issued a policy in March 1996 asking members to document their favourable decisions where the claimants' countries of origin accounted for significant differences in acceptance rates. To date, there has been very little follow-up on this policy; nor have members received feedback on the information thus gathered. In our opinion, a better knowledge of the case law related to the favourable decisions would contribute to more equitable decision making. The members agree that they should document their favourable decisions, but they are somewhat reluctant to do so given the deadlines imposed on them.

25.97 The Board is in the process of implementing a national strategy designed to ensure greater consistency in decision making. Given the recentness of these measures, it is too early to expect significant corrections in the discrepancies. In fact, we noted that after the first quarter of 1997 there were still serious discrepancies in the acceptance rates, even extending to additional countries.

25.98 **The Immigration and Refugee Board and Citizenship and Immigration Canada should ensure that Board members are supplied with the information needed to make well-reasoned and fair decisions.**

Board's response: Agreed. In the case of a few countries, there are significant discrepancies between offices in the way claims from one and the same country are handled. Each decision is rendered individually, however, by independent decision makers, based on the evidence submitted and the specific facts of the case. The members in each office have therefore been grouped into teams specializing in a geographic area to enable them to increase their expertise through greater sharing of knowledge and experience, both locally and nationally.

Numerous initiatives have been taken. The Board is currently reviewing its information-gathering system to ensure that information is more effectively managed, more focussed on the facts of each case and more consistent overall from one office to another. The Board also has a national training program that helps to shape a consensus among decision makers, notably in the form of pan-regional information sessions on conditions in certain countries (China, Israel, Somalia, India, Sri Lanka and the Czech Republic).

Department's response: In November 1995, a Memorandum of Understanding was signed by the two organizations for sharing information on refugee claimants and on country conditions from missions abroad. Under the terms of the MOU, client/claim-specific inquiries became possible for the first time. In 1996, missions abroad provided client-specific information for over 600 cases and country of origin information on over 75 cases.

The Board's practices need improvement

25.99 In the past several years, the Board has undertaken a series of changes designed to emphasize the non-adversarial nature of the refugee determination process, improve the quality of decisions and increase productivity.

However, these changes have not been adopted consistently throughout the Board. It is currently attempting to establish an organizational structure that will support the many changes made to the refugee determination system.

25.100 During our audit we noted a lack of rigour in a number of practices that has resulted in delays throughout the system, frustration among employees and opportunities for abuse of the system.

25.101 In the past, the Board used an expedited process to quickly handle, without a hearing, the claims that had a very good chance of being accepted. This process is being used less and less. For example, 43 percent of favourable decisions in 1993-94 were reached through this procedure, compared with 30 percent in 1996-97. We also noted that the practices used in the expedited process varied from one region to another. Most Board members and refugee claim officers told us that the results of the expedited process are not as reliable as those obtained through the normal process. In our view, the expedited process as it is currently designed no longer meets requirements, but we feel that such a mechanism is sufficiently important to efficiency to warrant an evaluation of its use.

25.102 To the extent that the Board has difficulty handling its workload, we expected that the priorities in processing would be set out clearly and would take risks into account. We noted that there are no clear directives governing the order of priority for processing cases, except the policy that claimants who are detained are to be heard first. Each region sets its own processing priorities based on its own strategy for clearing backlogs.

25.103 We noted that additional efforts are needed to encourage the various stakeholders in the refugee determination process to comply with the Board's rules and procedures. For example, several Board members and refugee claim officers consider that lawyers rarely disclose their information in a timely manner. Further, we noted that in 1996, 57 percent of the personal information forms received at the Board were late. Timely receipt of these forms is important because they initiate the determination process, and any lateness results in further delays.

25.104 Finally, Board members and refugee claim officers clearly indicated to us that postponements and adjournments caused by internal administration, claimants and their representatives are a major cause of Board delays. We noted that 49 percent of scheduled hearings in 1996 had to be either postponed or adjourned.

25.105 In the fall of 1996, the Board began to implement a wide range of measures designed to improve performance monitoring. For example, new mechanisms were put in place to ensure better follow-up on delays caused by writing reasons for decisions. Responsibility for achieving targeted results now lies jointly with the regional directors and the assistant deputy chairpersons in the Convention Refugee Determination Division. In April 1997, each region was asked to present its commitments and its projections for the two upcoming quarters.

25.106 Since the changes to the performance monitoring mechanisms were made only recently, we are unable to comment on their effectiveness.

25.107 The Immigration and Refugee Board should:

- **be more rigorous and consistent in its practices in the refugee determination process; and**
- **establish an overall strategy and monitoring mechanisms to ensure that it meets its operational objectives.**

***Board's response:** Agreed. The Board has already taken steps to clarify its practices and operational standards in relation to the refugee status determination process. Nevertheless, each office has a responsibility to adapt its practices to the local environment insofar as is necessary to increase its productivity and efficiency.*

The Board has commissioned various independent studies to improve its operational practices and monitoring mechanisms. Studies have been carried out on its information–gathering system and on its internal accountability structure. Reviews are currently under way concerning the management of its information system and, specifically, concerning its caseload tracking system. The Board will implement many of the conclusions and recommendations stemming from these reviews in the near future.

Organizational climate at the Board could jeopardize the success of initiatives to improve the refugee determination process

25.108 The Board is a relatively new organization that operates in a difficult environment. Refugee status is a sensitive subject that generates a great deal of public and parliamentary interest. Over the years, the Board has had to deal with a high turnover rate among its members and senior managers. Finally, the Board’s operations must integrate two parallel hierarchies: public servants and Board members.

25.109 Throughout our audit, we met people who are willing to contribute fully to carrying out the Board’s mandate. However, we were struck by the lack of a common vision on the part of those who work at the Board. In our view, there are major tensions between Board members and the public servants at the Board, and between staff and management.

25.110 We tried to identify the impact of the changes made by Board management over the past two years. We found that both Board members and refugee claim officers have a good understanding of the changes and are willing to continue their efforts to adapt to them. However, the two groups have very different perceptions of the effects of these changes. While the members’ assessments were consistently more positive, the refugee claim officers feel that the changes to the system have not had the anticipated effects. With these important two groups polarized on such fundamental issues, change management is probably going to become very difficult and the play of internal forces will favour the status quo by default.

25.111 In our opinion, the Board’s effectiveness depends greatly on the ability of members and refugee claim officers to work together. Our audit identified serious problems in the organizational climate. Indeed, most Board members and refugee claim officers describe the current organizational climate as negative or variable. Most members said that the organizational climate has improved or remained stable in the past 12 months. The refugee claim officers, however, were much more critical. In fact, the majority said the situation is deteriorating; one third said it has remained stable.

25.112 It is particularly worrisome to note that only half of the members and a minority of refugee claim officers feel that the current practices instil public confidence in the fairness and integrity of the system for dealing with refugee claims. Similarly, only a minority feel that the *Immigration Act* can protect Canadian society from abuse of the system. They cited several reasons to justify this rather troubling position. Among the factors most frequently cited were the non–adversarial nature of the refugee determination system, the lack of close co–ordination among the various stakeholders, the generousness of the legislative provisions concerning refugees, and the absence of sanctions against abuses. It should be noted, however, that members and refugee claim officers feel that the Board’s current practices allow Canada to comply with its international commitments.

25.113 The Immigration and Refugee Board should take urgent action to improve its organizational climate and develop a common vision among its employees.

Board’s response: *Agreed. The Board has launched an organizational renewal program that has enabled it to identify its values and adopt an organizational mission. Finally, senior management has developed and disseminated an organizational vision for the future. Furthermore, the Board encourages teamwork and constant dialogue among all levels of the organization, not only to improve the climate of work but also to promote best practices and innovation. Thus, the Board recognizes the need to continue these efforts.*

Handling Failed Refugee Claims

A slow, complex and ineffective process

25.114 Under the *Immigration Act*, refugee claimants are generally subject to a removal order from the time their claim is made, conditional on the decision of the Board. Failed claimants would normally be required to leave Canada soon after this decision. However, after the Board's decision, these claimants are entitled to other supplementary review mechanisms. They will generally be entitled to a reassessment of their need for protection — a reassessment based on the risk of return. They can also apply for permanent residence on humanitarian and compassionate grounds. Although they can use this mechanism at any time, it appears that they generally do so when they are ordered to leave Canada.

25.115 We reviewed the handling of failed refugee claims. Exhibit 25.13 shows the status of some 31,200 persons who claimed refugee status between February 1993 and March 1997 and whose claims were denied by the Board or were abandoned. Overall, our review found that the Department is having difficulty resolving these cases quickly and efficiently. The files go through a slow, complex process, and many cases remain unresolved.

Exhibit 25.13

(This exhibit is not available, see the Report)

25.116 As discussed in the following paragraphs, the review of risk of return currently contains ambiguities that raise questions about its merit. In its present form, this step is akin to a reassessment of the Board's decision. Further, it entails a duplication of effort that affects the efficiency of the entire claim process. We also found a lack of rigour in the assessment of humanitarian grounds cited by failed refugee claimants. Finally, the Department is having serious difficulties carrying out removals.

Questions about the efficiency and the results of the risk-of-return review

25.117 Under the Minister's discretionary power to create classes of persons to single out for special treatment, a class of persons called the Post-Determination Refugee Claimants in Canada Class was created by regulation in 1993. It was designed to protect claimants who fail to meet the Convention's definition of refugee but who nonetheless would face personal risk of harm if forced to leave Canada. Establishment of this class formalized a practice that the Department had used since 1989. According to the stated criteria, the risk must be compelling — consisting of a threat to life, extreme sanctions or inhumane treatment — and it must be personal — that is, directed at the individual rather than based on a generalized situation of risk in the country. The objective in this case is different from the Department's when it assesses the general conditions in a country to determine if carrying out removals to that country would be justified.

25.118 Since May 1997, claimants wishing this review have had to request it. Previously, with a few exceptions, all refugee claimants whose claims were denied by the Board automatically had their risk of return reviewed. The review is carried out at the Department by post-claim determination officers who work in units independent of enforcement operations. From February 1993 until March 1997, the Department had approximately 37,500 cases to assess, aside from close to 4,000 additional cases that became entitled to reassessment after the 1994 announcement retroactively broadening the interpretation of the criteria.

25.119 The criteria used by the Department in the risk review are very similar to those used by the Board in determining refugee status. Although the criteria used by the Board are based on the risk of persecution, as described in paragraph 25.8, the risk-of-return review criteria are based on risk of death, extreme sanctions and inhumane treatment. In our view, the distinction between these concepts is a very fine one.

25.120 Given this similarity and the stated objective, we would have expected the mechanisms used in the Department's risk review to clearly identify the types of danger it was aimed at avoiding and to complement the assessment carried out by the Board. However, this is not the case.

25.121 In assessing the risk of return, the Department's officers use information that is similar, and even identical, to that used by the Board — the personal information form completed by the claimant for the Board and the reasons for the Board's decision — along with any comments the claimant may have submitted to the post-claim determination officers. Further, the Department's guidelines are based on those developed by the Board.

25.122 The officers' decisions are also based on conditions in the country of return. From documentation centres they gather information on country conditions that is similar to the information produced and used by the Board. Officers in some departmental offices are specialized by geographical region, just as in the Board.

25.123 Given the similarities between the criteria applied to this class of claimant and the Convention definition, and given the methodology used, we question the objective being pursued and are concerned about the possibility that, in practice, the Board's decisions may be overturned by departmental officers. We have in fact noted certain cases where the considerations evaluated by departmental officers had already been evaluated by the Board under its mandate. We also noted that the officers cited factors to support the existence of risk to the claimant that had already been evaluated by the Board, or that would be if changes of circumstances were to be invoked in a subsequent claim.

25.124 Efforts have been made to improve the transparency and consistency of practices and to increase productivity. At 31 December 1994, there were approximately 16,500 cases pending compared with 8,500 at 31 March 1997. With respect to processing times, we estimate that in 1993 approximately 14 months would elapse between a Board decision and the risk review, including time at the Federal Court. In 1996, this figure was down to 7 months.

25.125 **Citizenship and Immigration Canada should ensure that the risk-of-return review is:**

- **within the scope of the objectives set for the Post-Determination Refugee Class in Canada; and**
- **carried out in an efficient and timely manner.**

Department's response: Agree. These risk considerations are necessary to ensure compliance with obligations not covered by the Geneva Convention; for example, Canada's obligations as a signatory to the Convention Against Torture.

The aim of regulatory amendments to the Post-Determination Refugee Claimants Class in Canada, introduced on May 1, was to ensure that the procedures themselves do not act as impediments to the expeditious removal of persons found not to be at risk upon return.

More rigour needed in evaluating humanitarian and compassionate grounds

25.126 Under the *Immigration Act* anyone, including a refugee claimant, may at any time and as often as desired file an application for permanent residence in Canada based on humanitarian and compassionate grounds. To be accepted on those grounds, claimants must convince the Department that they would suffer extreme hardship if they had to apply for permanent residence from outside Canada. This is a decision made by immigration officers in Canada.

25.127 Since granting permanent residence on humanitarian and compassionate grounds constitutes an exception to the general immigration rules, we expected that this avenue would be used with prudence and care. We expected also that the delegation of this power to immigration officers would be accompanied by an appropriate degree of monitoring. In fact, we found a lack of rigour in the use of this mechanism.

25.128 In our view, the use of the discretionary power in connection with applications for permanent residence on humanitarian and compassionate grounds lacks sufficient monitoring to ensure consistent decision making. Although there are several officers authorized to make such decisions, their supervision and training are very limited. Decisions are not systematically documented and are not subject to review unless they are contested. These types of monitoring deficiencies have also been pointed out by internal studies.

25.129 Further, the Department has insufficient information at its disposal to oversee the use of this provision effectively. It has no overall statistics, such as the number of failed refugee claimants who made such applications or the number of repeat applications. The information on claims and officers' decisions is limited and scattered, so that the Department has no easy way of knowing the circumstances that led officers to grant or deny permanent residence on humanitarian and compassionate grounds. Despite the lack of departmental statistics on the number of such claimants, from our analyses we were able to determine that of the 31,200 individuals who applied for refugee status between 1993 and 1997 and had their claims denied, approximately 2,300 were granted permanent residence on humanitarian and compassionate grounds. Most of these individuals were given favourable decisions because they were married to permanent residents or Canadian citizens.

25.130 **Citizenship and Immigration Canada should introduce a greater degree of rigour into the mechanisms surrounding decisions based on humanitarian and compassionate grounds.**

Department's response: Agree. The Department has already taken steps to improve humanitarian and compassionate processing. New guidelines, in the form of a new chapter to the Immigration Manual, will be completed in the coming weeks. This will be followed by training of departmental employees who apply these guidelines in Canada. In addition, case identifier codes have been developed on the types of cases being approved on humanitarian and compassionate grounds to provide statistical information and facilitate monitoring. These measures should improve the consistency of humanitarian and compassionate decisions without compromising the discretion legally delegated to the decision maker.

The Department is experiencing a great deal of difficulty carrying out removals

25.131 Citizenship and Immigration Canada is responsible for carrying out the removal of persons who have been denied permanent residence after all of the available review mechanisms have been exhausted. To preserve the integrity of the immigration program, in our view, removal orders need to be carried out quickly.

25.132 As seen in Exhibit 25.13, of approximately 19,900 claimants awaiting removal, just 22 percent had confirmed their departure by the conclusion of our audit. As for the rest, we estimate that those individuals who have not left may have been in Canada, on average, for two and a half years.

25.133 There are a number of factors that make it difficult to carry out removals quickly. Adding to the difficulty is the fact that a great deal of time elapses between the Board's decision and the completion of both the risk-of-return review and the assessment of humanitarian and compassionate grounds.

25.134 Another factor is that some countries refuse to issue travel documents to their nationals, and others take a long time to do so — up to four to six months. To address this problem, the Department recognizes that there is a need earlier in the process to initiate arrangements for obtaining travel documents. Extremely severe crises in some countries may also result in a temporary suspension of removals until the situation there stabilizes. Finally, a variety

of legal considerations, notably the carrying out of a decision by another tribunal, will affect the timing of the removal.

25.135 Apart from these factors, a number of individuals delay leaving or, in fact, elude the Department. In the Quebec region, for example, it is estimated that in 1996-97, 38 percent of persons considered ready for removal failed to report when required.

25.136 Finally, the extent and complexity of removal orders within the overall immigration program, along with the various degrees of risk associated with the non-removal of certain persons other than failed refugee claimants, are putting pressure on the Department's priorities for removal and investigation. Removals of failed refugee claimants dropped from 4,672 in 1992 to 2,465 in 1996, or from 65 percent to 42 percent of all removals carried out by the Department in that period.

25.137 The creation in 1994 of the Deferred Removal Orders Class is an indication of the impact of the difficulties in carrying out removals. This class was created to regularize the status of certain failed refugee claimants who had been awaiting removal for several years but whom the Department was unable to remove. Among those whom this provision was intended to cover were persons who could not be removed because they lacked travel documents or because there had been a breakdown of order in the country of origin, and others whose cases had been pending for too long at various stages in the process, including the risk-of-return review. More than 5,000 failed refugee claimants were accepted as members of this class. However, the class was abolished in May 1997.

25.138 We also noted that the Department has insufficient information to manage removals adequately. The available information does not allow for efficient tracking of the removal status of all failed refugee claimants. The Department does not know exactly how many persons are ready for removal. It compiles the number of removals of failed refugee claimants actually carried out but it does not know what success rate this represents in relation to all removals ordered. The Department recognizes that its computerized Field Operations Support System does not provide the management information needed to meet the enforcement function requirements. Over the years, the regions have had to develop their own systems to manage their workload. In 1996, the Department introduced a project to develop a new automated system — the Enforcement Case Management System — but the project was cancelled in August 1997 due to budgetary constraints.

25.139 The Department has limited room to manoeuvre because of certain external constraints. The lack of co-ordination and management information nevertheless impact on the effectiveness of the removal process. Effectiveness needs to be improved because decisions made during the process have real value only if they are carried out promptly. We made similar observations in our 1990 Report.

25.140 **Citizenship and Immigration Canada should ensure that it has the information needed to manage removal-related activities and it should take steps to increase its effectiveness at removals.**

Department's response: Agree. We acknowledge that upgraded information systems would improve the capability to manage removal-related activities. The Department is managing several information technology issues and some initiatives that are proceeding will support the removals function. These include centralizing enforcement information through the establishment for the greater Toronto area of a centralized enforcement office supported by an integrated enforcement case management system to help track cases for removal activities.

The Department has also developed a removals strategy comprising complementary measures designed to support the removals function. These include the negotiation of bilateral removal arrangements with other countries (six signed to date); measures to encourage voluntary compliance with removal orders (e.g. use of cash bonds); increased exchange of information on best practices among removal offices; and the pursuit of various diplomatic channels to obtain the co-operation of countries that refuse, or take too long, to issue travel documents to their citizens.

Accountability and Information to Parliament

A need for more complete and relevant information to parliamentarians

25.141 The Department and the Board submit separate Estimates to Parliament, each providing information on its programs, activities, costs, and expected as well as actual results. We reviewed both agencies' documents and noted that, on the whole, they do not provide Parliament with complete and relevant information on the processing of refugee status claims. First, there is no information on interdepartmental performance. Second, the quality and quantity of the information presented on the various claims-processing activities vary greatly.

25.142 The government's Program Review confirmed that the protection of refugees was one of the primary functions of the Citizenship and Immigration Program. One would therefore expect that the Department would account for the government's performance in this regard, based on a set of overall expectations. However, we noted from the Department's Expenditure Plan for 1997-98 that the planning data and performance-related information did not contain any substantial comments on the processing of refugee claims. No information was provided on the performance of activities carried out by other federal agencies such as the RCMP, the Federal Court and CSIS. In addition, the information presented by the Department on refugee claimants was combined with information on other activities or sub-activities and was therefore difficult to extract. However, the Department recognizes that given the changes resulting from the re-engineering of administrative processes that began in 1995, it will have to change its accountability framework. Also, the Department has indicated that it intends to develop performance measurements based more on results than on process.

25.143 The Board was part of a group of 16 entities that participated in the Improved Reporting to Parliament Project, set up by the Treasury Board Secretariat to improve the quality of expenditure management information sent to Parliament and to modernize its preparation. As part of this project, the Board presented its Performance Report in 1996 and, in 1997, its Report on Plans and Priorities. We reviewed the information contained in these documents, particularly the information related to the Refugee Division. We observed that the reports place considerable emphasis on the improvements needed in the areas of service delivery and workload management. A number of indicators are presented, such as the number of decisions made, the average cost per decision and average processing times. The information describing activities and the related outputs had improved but, like a number of other entities within the federal government, the Board needs to place more emphasis on the outcomes of its activities related to refugee status determination. It needs to broaden the scope of its indicators to account more specifically for its achievements in the area of informed and equitable decisions.

25.144 **Citizenship and Immigration Canada and the Immigration and Refugee Board should ensure that parliamentarians receive the information needed to hold the government to account for the performance of all activities related to the processing of refugee status claims.**

Department's response: Agree.

Board's response: Agree.

Conclusion

A Thorough Review of the System Is Required

25.145 The current refugee claims processing system is the product of a number of modifications made since 1989 to address specific problems. In our view, the current process does not quickly grant Canada's protection to

claimants who genuinely need it. Furthermore, it does not discourage from claiming refugee status those who do not require or deserve Canada's protection.

25.146 Although we offer suggestions for improving results at each stage in the process, we caution the government against making patchwork changes. We believe that the problem is complex and that there is a need to conduct a thorough review of the refugee claim process. For example, it may be necessary to review the division of responsibilities among the various stakeholders as well as their respective roles. The infrastructure for co-ordination and control urgently needs to be improved.

25.147 Finally, it is important to realize that there are inherent limits to the improvements that can be made in the performance of the existing system. Both the Department and the Board operate within a framework that reflects the choices made by Canadian society over the years on refugee-related issues. For example, the application of the *Charter*, the nature of our social programs, the various benefits allowed to claimants, our level of tolerance for people who attempt to abuse the system, the non-adversarial nature of the process, and the various remedies available to failed claimants all significantly influence the performance that can be expected from the system.

25.148 Therefore, in the event that the system is revised, it is essential that realistic expectations for the speed and efficiency of claims processing be set out in keeping with the choices we as a society have made. It is also important that the responsible federal agencies respond to these expectations within well-defined parameters.

25.149 During the course of our audit, the Minister of Citizenship and Immigration established an Immigration Legislative Review Advisory Group tasked with formulating recommendations to guide and update future immigration and refugee legislation. Among other things, the review will include ensuring the integrity and efficiency of the refugee determination process. The Advisory Group has held numerous consultations in 1997 with various immigration and refugee stakeholders. We have been informed that it is expected to submit its report to the Minister by 31 December 1997.

Department's general comments:

The Department appreciates the challenge the Auditor General faced in analyzing refugee claims processing in Canada. Fairness and efficiency are legitimate and important objectives, but sometimes tensions can exist between them that complicate the process of refugee status determination. Since the revision of the refugee status determination processes in 1989, the Department has introduced measures to improve both the quality and efficiency of the process. The Department recognizes that greater efforts need to be made in the co-ordination of the various processes and in improving information systems to allow for better management and accountability.

As mentioned in the chapter, last November the Minister created a Legislative Review Advisory Group to review the current system and make a series of recommendations to guide and update future immigration and refugee legislation. The Auditor General's comments and recommendations will be of timely benefit in the deliberations that will follow the release of the report of the Legislative Review Advisory Group.

Refugee-accepting countries are struggling with their refugee determination systems to ensure high-quality, timely decisions in the face of pressures created both by the influx of asylum-seekers and by domestic fiscal realities. While dealing constantly with new challenges, the Department also seeks "best practice" solutions through multilateral and bilateral discussions with like-minded countries and the United Nations High Commission for Refugees.

About the Audit

Scope

The audit covered the processing of refugee claims made in Canada. We examined the following three main steps: determination of eligibility of the claim; determination of refugee status; the settlement of cases of claimants whose claims have been denied by the Immigration and Refugee Board.

Our audit was carried out primarily at Citizenship and Immigration Canada and the Board. We also met with representatives from the Royal Canadian Mounted Police and the Canadian Security Intelligence Service. We gathered audit evidence from discussions with staff, examining claimants' files, consulting management documents and databases, and observing a number of hearings. We also surveyed all Board members and all refugee claim officers. As of 2 September 1997, a total of 173 persons had responded to our questionnaire, for an overall response rate of 62 percent, which gives us a reliability rate of 95 percent and a margin of error of approximately 5 percent. Also, the characteristics of the respondents correspond closely to those of the general population surveyed.

Objective

We sought to determine whether management mechanisms allowed for the efficient and fair resolution of refugee claims and fostered public confidence in the fairness and integrity of the process.

Criteria

We expected to find that:

- the organization of activities and the distribution of resources reflect the inherent risks and promote the efficiency and effectiveness of the overall process;
- activities are integrated and co-ordinated in such a way as to optimize the sharing of the information and skills required for decision making;
- there are procedures to ensure that qualified staff are hired and retained to perform the various duties;
- staff have tools and relevant information for decision making;
- there are processes that make it possible to closely monitor operational performance, compliance with authorities, and the results obtained; and
- the information intended for Parliament is relevant, reliable and understandable.

Audit team

Roch Cholette
Martin Dompierre
Denis Labelle
Alain Soublière
Suzanne Therrien
Chantal Thibaudeau

For information, please contact Serge Gaudet, the responsible auditor.

Chapter 26

Canada Labour Relations Board

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Canada Labour Relations Board

Assistant Auditor General: David Rattray

Responsible Auditor: Alan Gilmore

Main Points

26.1 In our May 1995 Report chapter on ethics awareness in the federal government, we proposed that the guiding principle for public office holders be that “public service is a public trust.” The object of the government’s Conflict of Interest and Post–Employment Code for Public Office Holders is to “enhance public confidence in the integrity of public office holders and the decision–making process in government.” We agreed with the general principles of the Code. Of particular relevance to our present audit is the principle that “public office holders have an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.”

26.2 We found that certain financial practices of the Canada Labour Relations Board (CLRB) would not “bear the closest public scrutiny”. Recent reviews of the Board have consistently found major organizational and performance problems resulting, in large part, from an ongoing conflict between the Chair and the Vice–Chairs over control of the work of the Board.

26.3 This dispute has contributed to the undermining of financial and management controls over case processing and scheduling and over travel expenditures. Proposed legislation that failed to pass in the Senate before Parliament was dissolved in April 1997 would have given the Chair authority for “supervision and direction over the work of the Board.”

26.4 After their terms as board members have expired, former board members continue to hear ongoing cases with which they have been involved. However, clear time frames for completing hearings and writing decisions are not established. The cost effectiveness of this type of open–ended appointment of former members is questionable. During the period April 1989 to March 1997, about \$1.7 million was spent for former board members to continue to hear cases. This is equivalent to paying about 14 full–time board members for one year. When their terms expired, a total of about \$595,000 was paid to former board members in severance entitlements and for unused vacation leave.

26.5 Until they were revised in January 1997, certain of the CLRB’s policies on reimbursement of travel expenses for accommodation, food and incidentals were not reasonable or consistent with legislative authority. We also concluded that the Chair’s pattern of expenditures on travel and hospitality is not reasonable.

26.6 We make recommendations to address management and financial control problems in the Canada Labour Relations Board as well as systemic issues involving Governor in Council appointees. We also identify issues that we believe need to be brought to the attention of Parliament at this time.

Introduction

26.7 Established in 1948, the Canada Labour Relations Board (CLRB) investigates, adjudicates and renders decisions on matters covered by the *Canada Labour Code* — for example, certification of bargaining agents and unfair labour practices such as failure to bargain in good faith. About 700,000 workers fall under the jurisdiction of the *Code*; the majority are employed in railways, Crown corporations, airlines, chartered banks, interprovincial trucking, telecommunications, shipping and broadcasting.

26.8 The CLRB as a division or branch of the federal government is subject to the *Financial Administration Act* and most Treasury Board regulations and policies. The CLRB consists of a Chair, five Vice-Chairs, and eight board members. All are appointed by the Governor in Council (GIC) for fixed terms. Board members hold office during good behaviour and are removable by the Governor in Council for cause. The Chair is the chief executive officer. The present Chair is appointed at the GIC-10 level for a term not exceeding 10 years, with a salary range of \$128,100 to \$155,800. The present Vice-Chairs are appointed at the GIC-9 level for a term not exceeding 10 years, with a salary range of \$117,000 to \$142,400. Other board members are appointed for five-year terms at the GIC-5 level, with a salary range of \$80,100 to \$94,500. The Board has a staff of about 94 public servants. It is located in Ottawa, but maintains regional offices in Vancouver, Winnipeg, Toronto, Dartmouth and Montréal.

26.9 The CLRB's Part III Estimates indicate that in 1995-96 it received about 839 new files and disposed of about 826 files; 440 files were pending at year end. Hearings are held throughout the country in both official languages. The Board's total expenditures for 1997-98 are estimated at \$8,901,000, including the salaries of board members and employee benefits. An additional \$2,601,000 in services will be provided to the Board without charge by other government agencies.

Focus of the audit

26.10 In April 1997, the government requested that the Office of the Auditor General review travel expenditures, allowances and benefits reimbursed to the Chairman and board members of the Canada Labour Relations Board. We agreed to conduct the audit pursuant to the *Auditor General Act*. Our audit objective was to determine whether the travel and hospitality expenditures of board members were consistent with legislation and policy and whether they were reasonable. We relied on recent major reviews of the Board to identify underlying organizational, performance and financial control problems that needed to be brought to the attention of Parliament at this time. Further details on the audit are in **About the Audit** at the end of the chapter.

Observations and Recommendations

Major Organizational and Performance Problems

26.11 Prior to our audit there had been four major reviews of the Canada Labour Relations Board: the November 1993 Organizational Review; the November 1995 Workplace Climate Review; the January 1996 report of the Task Force on Part I of the *Canada Labour Code*, entitled *Seeking a Balance: Review of Part I of the Canada Labour Code*; and the December 1996 internal audit of travel and professional services contracting, conducted by Human Resources Development Canada. The Organizational Review and the Workplace Climate Review were initiated by the Chair on the recommendation of senior staff of the Board. The findings of these reviews are significant and consistent.

Ongoing Conflict between Chair and Vice-Chairs

26.12 The 1993 Organizational Review found that the Chair and the Vice-Chairs did not agree on fundamental issues of control and authority. The Review stated:

There are fundamental issues of authority with respect to implementing change to certain aspects of the case processing cycle such as the assignment of cases to Governor-in-Council personnel, selecting Board panels, and co-ordinating/scheduling panels to travel and hear cases.

The Review concluded that the resolution of these issues of authority “requires further study by others and perhaps amendments to the *Canada Labour Code*.”

26.13 The 1995 Workplace Climate Review found an ongoing conflict between the Chair and the Vice-Chairs over control of the Board. The Chairman holds that the Chair is the chief executive officer of the Board, pursuant to the authority provided by the *Canada Labour Code* and other enabling legislation such as the *Financial Administration Act*. The Vice-Chairs hold that, under the *Code*, the Board should operate as a corporation’s board of directors, with major decisions taken by vote. Legal opinions have been sought by both sides to support their respective positions.

26.14 The Workplace Climate Review concluded, “The ongoing battle between the Vice-Chairs and the Chairman with regard to the role of the Vice-Chairs and the Chair has had a profoundly negative impact on the working environment. Interviewees provided an overwhelming abundance of information to illustrate their belief that the uncontained, unchecked behaviour of GICs and the Chairman’s office compound the atmosphere of discord.”

26.15 Furthermore, the Review reported, “The fallout of this struggle is measured in human terms. Quite apart from the obvious reduction of individual productivity and efficiency, respondents expressed a range of frustration along a continuum stretching from impatience and irritation to deep psychological torment reportedly requiring therapy and medication.”

26.16 Control over assigning members to panels to hear cases and over scheduling of cases was one of the major areas of conflict between the Chair and the Vice-Chairs. The Vice-Chairs believed that collectively they had the authority to assign cases to board members and to schedule cases for hearing. The Chair believed this authority was his. One of the consequences of this conflict was that during a six-week period from mid-April to May 1993, and again from September 1995 to December 1995, the Vice-Chairs refused to accept new cases that were being processed under a new policy established by the Chair. However, they continued to work on cases already assigned.

26.17 In 1995 the Chair and the Vice-Chairs brought the conflict between them to the attention of the ministers of Labour and of Justice, and the Privy Council Office. The Privy Council Office recommended a mediation process to resolve the conflict.

26.18 The mediator’s October 1995 memorandum to the parties concluded:

In my mind, the stated issues confronting the C.L.R.B. are relatively simple ones which have been exacerbated by a variety of factors which have virtually destroyed co-operation and normal communications. In such a climate, it is not surprising that relatively minor issues become so dominant. In my view, therefore, the Case Management system is merely a symptom of a much deeper malaise. Moreover, the polarized legal positions taken by the Chair and the Vice-Chairs are both extreme, and as with most polarized views, the truth lies somewhere in between.

I believe that the problems of the C.L.R.B. are due to poor management practices, inadequate and paper-oriented communications, poor leadership from senior Members of the Board and a general lack of professionalism and accountability, which have created a climate which is at times venomous, harassing, stressful, and which undoubtedly is eroding morale, the quality and efficiency of the Board's work, and the Board's internal and external credibility and integrity.

26.19 The 1996 report of the Task Force on Part I of the *Canada Labour Code* commented on the consequences of this conflict. It noted:

Deeper problems at the Board surfaced publicly during our review. Articles appeared in the national newspapers. Vice-Chairs and some members refused to accept assignments under a new scheduling system introduced by the Chair, in an action some refer to as a strike. Court applications and complaints to the Canadian Judicial Council were threatened, launched and discussed publicly.

26.20 About \$203,000 of public funds was spent on legal fees for the Chair and Vice-Chairs before the conflict over assigning and scheduling cases was brought to an end. The mediator's fees totalled \$14,000.

26.21 While the disagreement between the Chair and the Vice-Chairs over the case assignment and scheduling process has been resolved as a result of mediation, the underlying disagreement over their respective responsibilities remains. The 1996 Task Force report concluded:

Some of the problems with the present Board involve subtle but fundamentally different views of what the Board should be and how it should be run. These problems are rooted in the legislated structure of the Board, which fails to provide appropriate checks and balances. Two flaws are central. First, there is no clear delineation of executive powers within the Board. Second, the appointment process fails to ensure that Board appointees have the necessary skills, community respect and experience.

26.22 In 1995 this Office reviewed the activities of the CLRB to determine if a full value-for-money audit was warranted. We brought the need to resolve the long-standing dispute to the attention of the Chair and the Department of Labour, and noted that legislation might be required to resolve it. We also recommended that the Board restate its mission and values and establish a code of conduct, and that internal audits of key operations be conducted. In particular, travel expenditures required immediate audit attention.

Inadequate Performance Level

26.23 The 1996 Task Force review of the CLRB's performance concluded that decisions were not being made in a timely manner. It noted, "Various audits, internal and external, conducted over the last few years, have created an awareness within the Board of just how long cases are taking and why. Despite this, little of substance has been achieved to reduce these figures in any appreciable way." Exhibit 26.1 presents information on the performance of the Board.

Exhibit 26.1

Information on Board Performance

	1994-95	1995-96	1996-97
No. of full-time and former board members	17	18	14
Total public hearing days	277	217	240

Range of sitting days of Chair and Vice-Chairs	33-65	18-50	26-57
Average sitting days of Chair and Vice-Chairs	48	34	42
Sitting days per month per person (Chair and Vice-Chairs)	4	2.8	3.5
Days to process case without public hearings	168	126	128
Days to process case with public hearings	389	399	451

26.24 The Task Force reported that the average time taken in 1994-95 to process a case without a hearing was 168 days, and with a hearing it was 389 days. We asked the CLRB for additional information on performance. The information indicates that progress has been made on reducing the average time taken to process a case without a hearing. In 1995-96 and 1996-97 the average processing time to hear a case without a hearing was reduced to about 127 days. However, the average time taken to process a case with a hearing has increased from 389 days in 1994-95 to 399 days in 1995-96 and to 451 days in 1996-97.

26.25 The Task Force reported that the CLRB's 17 full-time and former members sat in public hearings for a "total of only 277 days" during the 1994-95 fiscal year. It also reported that "leaving aside those newly appointed or retiring Vice-Chairs, sitting days run from 33 to 65 days a year per Vice-Chair or Chair, an average of 48 days per year or four sitting days per month per person." The Task Force concluded that while it recognized that "the Board does much of its work without in-person hearings ... this is a surprisingly low amount of sitting time. It reinforces the many concerns raised about timeliness."

26.26 The Task Force did not find that the need for board members to travel explained the low amount of sitting time.

Travel is one factor to be considered. However, as [the 1994-95 data show], about three quarters of the Board's cases are heard in Quebec and Ontario within reasonable proximity of the National Capital Region. A large proportion of these cases are held in Ottawa, or in Montréal or Toronto, each within a one hour airlift from Ottawa.

On average, in 1995-96 and 1996-97 about two thirds of the Board's cases were heard in Quebec and Ontario.

26.27 The Task Force concluded, "The current level of performance is unacceptable to the community it serves and falls well short of what is possible with the resources at the Board's disposal." The Task Force recommended a number of major organizational changes to address this issue. We requested additional information from the CLRB on public and *in camera* sitting days.

26.28 As indicated, during fiscal 1994-95, board members sat in public hearings a total of 277 days. The time spent in public hearings by board members has not increased. In fiscal 1995-96 the Board's 18 full-time and former members sat in public hearings a total of 217 days; in fiscal 1996-97 the Board's 14 full-time and former members sat in public hearings for a total of 240 days.

26.29 In fiscal 1995-96, public hearing days ran from 18 to 50 days a year per Vice-Chair or Chair — an average of 34 days per year or an average of 2.8 hearing days per month per person. In fiscal 1996-97 public hearing days ran from 26 to 57 days a year per Vice-Chair or Chair — an average of 42 days per year or an average of 3.5 hearing days per month per person. During the period April 1997 to September 1997 hearing days per Vice-Chair or Chair averaged 3.1 days per month per person.

26.30 The majority of cases are heard by the CLRB without a public hearing. These *in camera* hearings involve cases such as union certifications and revocations. Several meetings can be held in a single day. Meetings may last five minutes or several hours. The Board could provide us with information only on total meetings. It could not provide us with information on meetings per day. Therefore, we could not estimate the total number of *in camera* hearing days or the average number per person.

Personal convenience appears to influence the scheduling of cases

26.31 The 1995 Workplace Climate Review reported that certain board members were perceived to be scheduling “their work, particularly out-of-town work, around holidays or weekends ‘to suit their own convenience’, rather than in an expedient and cost-effective manner for the organization.”

26.32 The 1996 Task Force report also found that the current system of case scheduling “includes too much opportunity for the personal convenience of the Chair, Vice-Chairs and members to dictate scheduling matters.” The Task Force stated:

We heard far too many concerns expressed, from parties as well as from persons within the Board, about personal interests taking precedence over the needs of the Board and its clients. Travel preferences in terms of time and location, scheduling conflicts with personal commitments, and preference as to which colleagues to travel with, are perceived as playing too large a role in the Board operations. Many of these complaints are admittedly anecdotal. However, the volume and consistency of these concerns cannot be ignored because they are prejudicing the respect the Board needs to be effective.

26.33 The Vice-Chairs of the CLRB do not agree with the findings of the reviews we have cited. Further, they believe “the Board has been operating well and efficiently” since the Board adopted the recommendations of the mediator in November 1995. However, as we have noted, recent reviews have consistently reported similar major organizational and performance problems in the CLRB.

Policies deviated significantly from those of the government

26.34 A significant consequence of the dispute between the Chair and the Vice-Chairs was that it reduced the Chair’s ability to act as deputy head of the Board for the purposes of the *Financial Administration Act*. The internal audit conducted by Human Resources Development Canada noted that the dispute reduced the authority of senior financial officers to resolve financial control issues.

26.35 The internal audit also noted that there was a lack of understanding on the part of Governor in Council appointees of the role of the senior financial officer of the Board. The senior financial officer of a government entity is responsible for:

- devising and implementing a financial management organization and processes in the entity; and
- implementing policies and procedures that protect against violation of financial rules and principles, financial negligence, losses of assets or public money, and fraud.

26.36 In 1996, Treasury Board policy was revised to require the senior financial officer to seek the advice of the Deputy Comptroller General “in the event that a senior financial officer is convinced that an action his or her deputy head is proposing will create significant financial risk or will violate either the spirit or the form of the financial requirements of any legislation, regulation, or government policy.” If the deputy head does not accept the advice offered by the senior financial officer, the deputy head must discuss the matter with the Comptroller General.

26.37 We found that successive senior financial officers of the CLRB have advised the Chair and board members that CLRB practices deviated significantly from government policies. For example, in 1989 the Chair was advised that the CLRB's per diem policy for board members was not consistent with the Treasury Board policies. He was advised that the CLRB's policies also deviated from government practices by:

- providing for “full day and half day per diem allowances regardless of use of commercial accommodation”;
- permitting the “accumulation and personal use of frequent flyer points”;
- allowing “open-ended use of long distance telephone calling cards”;
- giving “blanket approval to use personal vehicles for Ottawa–Montréal–Toronto trips at the higher rate of reimbursement”;
- providing “free indoor parking spots for each appointee”;
- allowing “flexible leave recording procedures leading to high cash payouts at the end of term for unused vacation leave”; and
- permitting a “flexible approach to taking time off to compensate for overtime work on weekend travel.”

The Chair was also advised that “the entire matter should be examined.”

26.38 The Chair has tried to improve financial management of the CLRB. For example, in March 1994 he issued a set of standards for financial practices to improve efficiency and reduce costs. He noted that the CLRB “must now address certain financial practices which do not comply with Treasury Board directives or with the spirit of the Government's philosophy concerning the expenditure of taxpayers' dollars.” He also noted, “Treasury Board has made clear to this Board and to other organizations that the status quo will not be tolerated with respect to the current level of expenditures. As Chief Executive Officer, it is my responsibility to ensure that the Government's financial policies are respected.”

26.39 We found that most of the Chair's policies and the advice of senior financial officers on significant matters were not implemented, in large part because of the ongoing disagreement about control over the work of the Board and an apparent lack of understanding of the role of the senior financial officer.

26.40 **The Privy Council Office and the Treasury Board Secretariat should clearly explain to Governor in Council appointees, particularly those in small entities, the role of the deputy head and the senior financial officers under the *Financial Administration Act* and Treasury Board regulations and policies.**

Legislation would have given the Chair clear authority over the Board's work

26.41 As indicated above, the Chair and the Vice-Chairs' disagreement over control of the Board's work has had serious consequences. Recognizing that a legislative solution was required, in November 1996 the government introduced legislation that would have resolved the dispute by clearly granting the Chair authority over the work of the Board. However, the legislation was not passed by the Senate before dissolution of Parliament on 25 April 1997.

26.42 The proposed legislation provided that:

The Chairperson is the chief executive officer of the Board and has supervision over and direction of the work of the Board, including:

- (a) the assignment and reassignment of matters that the Board is seized of to panels;
- (b) the composition of panels and the assignment of Vice–Chairpersons to preside over panels;
- (c) the determination of the date, time, and place of hearings;
- (d) the conduct of work of the Board;
- (e) the management of the Board’s internal affairs; and
- (f) the duties of the staff of the Board.

26.43 The government should take the necessary steps to reintroduce appropriate legislation to clarify responsibility for the work of the Board.

Payment of legal expenses not consistent with authorities

26.44 The Task Force noted that, as a result of the disagreement between the Chair and the Vice–Chairs, “court applications and complaints to the Canadian Judicial Council were threatened, launched and discussed publicly.” The Chair incurred legal expenses of about \$132,000 for private counsel as a result of a threatened lawsuit by the Vice–Chairs. The Vice–Chairs incurred legal expenses of \$71,000. These legal expenses were in addition to about \$14,000 paid for the mediation process referred to in paragraph 26.20. All the legal expenses were paid by the CLRB.

26.45 The Chair approved the payment of his legal expenses under the Treasury Board Policy on Provision of Legal Assistance to Crown Servants. The Treasury Board Secretariat confirmed that this policy does apply to the Canada Labour Relations Board and to the Chair’s expenses. However, the policy requires that ministerial approval be obtained for payment of private legal expenses exceeding \$10,000. The Chair did not obtain the necessary ministerial approval for the payment of his \$132,000 in legal fees. The CLRB did not have information on the hourly rates charged by most of the lawyers hired by the Chair and thus could not verify whether their rates conformed with the Department of Justice guideline of \$200 per hour. The Department of Justice informed us that it would have had no authority to enforce the \$200 hourly rate because it did not appoint the counsel.

26.46 The CLRB also paid about \$71,000 for the private legal fees of the Vice–Chairs using the Treasury Board *ex gratia* policy. An *ex gratia* payment is defined as “a payment made to anyone in the public interest for a loss or expenditure incurred for which there is no legal liability on the part of the Crown.” The CLRB used the *ex gratia* policy after concluding that the Treasury Board policy on legal assistance did not apply because it does not authorize payments for legal services when a public office holder initiates a lawsuit.

26.47 The CLRB informed this Office that it believed the payment of these legal fees could be made under the Treasury Board policy on *ex gratia* payments because it was in the “public interest.” A memorandum from the mediator of the dispute, however, indicates that the “Vice–Chairs ask that the CLRB pay their legal fees as a condition of agreement” to a revised case management system and a resolution of the dispute.

26.48 In our opinion, the CLRB did not have the authority to make the *ex gratia* payment to the Vice–Chairs for their legal fees. The Treasury Board policy on *ex gratia* payments clearly states that the policy “is not to be used to fill perceived gaps or compensate for the apparent limitations in any act, order, regulation, policy, agreement or

other governing instruments...” The policy on legal assistance is intended to address compensation for legal expenses of Crown servants who are sued; it does not cover Crown servants who initiate claims. We do not believe that the CLRB had the authority to disregard this and compensate the Vice-Chairs using the *ex gratia* policy.

26.49 The government should identify and promptly address major internal legal disputes in boards, commissions and councils.

Questionable cost effectiveness of open-ended appointments of former members

26.50 Former board members, on the recommendation of the Chair of the CLRB and the Minister of Labour, may continue to “carry out and complete any duties or responsibilities that the member would otherwise have had, if he had not ceased to be a member.” There is no fixed date for termination of services.

26.51 The orders-in-council issued state that former board members will be paid a fixed “salary” for each day worked. From May 1989 to March 1997, the salaries per day ranged from \$375 to \$470 for former board members, \$650 to \$705 for former Vice-Chairs, and \$750 to \$775 for a former Chair. According to the Privy Council Office, the orders-in-council establish an employer-employee relationship.

26.52 Normally, salary payments in such circumstances are made from the salary budgets of agencies and a tax receipt is issued. The CLRB pays the salaries of former board members from its budget for professional and special services. The former members invoice the Board for days worked on a case. Payments to some former board members are made out to firms. Tax receipts are issued only at the request of a former member.

26.53 In our opinion, the CLRB does not have the authority to make salary payments to anyone other than the former board member identified in the order-in-council. Thus, the CLRB would properly make the salary payments with the appropriate income tax deductions directly to the former board member.

26.54 During the period April 1989 to March 1997, about \$1.7 million was paid to former board members for about 3,100 days of service. About 650 days involved sitting in public hearings. Former board members are paid the same travel per diem as full-time members if travel is required to hear cases. About \$221,000 was paid to former board members for travel expenses during the period April 1989 to March 1997. This amount does not include airfare paid directly by the Board. Former board members also received about \$595,000 in severance entitlements and for unused vacation leave when their terms as board members expired.

26.55 In March 1994, the use of salary per diems was questioned by the Chair. He noted:

The costs associated with per diems are expected to reach almost half a million dollars for 1993-94, enough to pay the salaries of four full-time members. The time has come to institute a managed approach to this budget item. For the first time Treasury Board has inquired as to how this item is managed and what policies exist to avoid abuse. They have also asked why this Board is the primary user over similar agencies in allowing per diems once terms have expired. Unfortunately, no written policies exist which would deal with the valid concerns expressed by Treasury Board.

26.56 The Chair also advised board members that the following practices would be adopted to address those concerns:

Having consulted the Privy Council Office, our organization will be putting into practice the following concepts which should alleviate concerns about the manner in which the per diem budget is managed. A moratorium on the assignment of cases will be imposed three months before the end of a GIC's term, exceptions are to be approved by the Chairman. The assignment of GICs to any potentially long-term case

must have the Chairman's approval, where the GIC is entering the final six months of the appointment term. At the end of the GIC's term, any cases with which the member has not been unequivocally seized may be reassigned by the Chairman, depending upon the needs of the organization....Members who are on per diems must not be asked to write majority decisions for the panel.

26.57 These policies were not implemented and the 1996 report of the Task Force reiterated the concerns. The Task Force stated:

Section 11 of the Code allows board members to continue to sit on cases after the expiry of their appointments. This has led to the practice of assigning some members to numerous hearings just before the end of their terms. In the past, this has been a precaution against delays in the appointment of new members. However, it should not be used as an end-of-term benefit for members returning to the private sector. The numbers of such assignments and their cost suggest that this power has been overused in situations where current appointees remain under-utilized.

26.58 The government should make the continued appointment of former members of entities like the Board subject to specific guidelines that do not allow for their tenure to continue for more than a reasonable period.

Travel by Board Members

Long-standing confusion and concern about travel expenditures

26.59 There has been a lengthy debate as to whether the Treasury Board travel and hospitality policies apply to the Canada Labour Relations Board. In 1996, in response to a recommendation by our Office, an audit of travel expenditures of the Board was conducted by the internal audit bureau of Human Resources Development Canada. The audit concluded:

All CLRB travel clearly falls under the TB Travel Directive. Accordingly, actual expenses are to be reimbursed up to an amount judged by the employer to be reasonable. Although they have full discretion in some areas, the Chairman and the Vice-Chairs are also subject to the general principles of the Travel Directive, including economy and reasonableness of expenses.

26.60 As a result, in January 1997, the current Chair revised the travel policies relating to board members, noting that the Chair "did not have the proper authority to replace TB Travel Directives with a per diem system which pays more than is allowed in the directives." He terminated the per diem policy and instituted practices that comply with Treasury Board directives.

26.61 In light of the controversy and its implications, we reviewed the applicability of the Treasury Board travel policies to the members of the Board of the CLRB.

The general principles of the Treasury Board Travel Directive are not clearly specified

26.62 As indicated, the 1996 internal audit concluded that all CLRB travel is subject to Treasury Board policies. The Treasury Board is responsible for establishing the terms and conditions of employment for full-time Governor in Council appointees. The Privy Council Office publishes a booklet that summarizes and communicates these policies to Governor in Council appointees. The Privy Council Office revised its booklet in June 1997. The booklet's summary of the Treasury Board policy on business travel expenditures for full-time Governor in Council appointees is:

Deputy Ministers (DM 1–3) and appointees at the GIC 9–11 levels may use business class air travel. They may claim expenses in excess of the per diems, based on receipts subject to the general principles specified in the Travel Directive (i.e., commercial accommodation, telephone calls, meals and incidentals).

26.63 It should be noted that Privy Council Office booklet states that travel expenses claimed must be based on receipts and are “subject to the general principles specified in the [Treasury Board] Travel Directive.” In reviewing the Treasury Board Travel Directive, we found that there is no section summarizing its “general principles”; rather, the principles are scattered throughout the policy and require that inferences be made as to what the standard may be. In addition, the Treasury Board Special Travel Authorities state that Governor in Council appointees have “full discretion” in making travel expenditures subject to the “general principles”. The inclusion of the phrase “full discretion” creates additional confusion.

26.64 **The Treasury Board Secretariat should clearly specify the “general principles” that guide travel expenditures of senior Governor in Council appointees.**

CLRB has the legislative authority to make its own travel policies

26.65 In July 1997, as the result of further inquiries, the Treasury Board Secretariat confirmed that the CLRB has the legislative authority to make its own travel policies for its Governor in Council appointees without the approval of the Treasury Board. The CLRB can also make its own hospitality policies for hospitality expenses incurred when board members are away from their ordinary place of residence.

26.66 The CLRB’s legislative authority to make its own travel and hospitality policies is contained in section 12 of the *Canada Labour Code*, which states:

Each member of the Board and person carrying out duties or responsibilities under section 11 (a) shall be paid a salary to be fixed by the Governor in Council; and (b) is entitled to be paid reasonable travel and other expenses incurred by him while absent from his ordinary place of residence in the course of his duties under this Part.

As discussed below, at times the CLRB has not used relevant authorities in an appropriate manner.

Certain questionable expenditures by board members

26.67 The government’s Conflict of Interest and Post–Employment Code for Public Office Holders states, “Public office holders have an obligation to perform their official duties and arrange their private affairs in a manner that will bear the closest public scrutiny, an obligation that is not fully discharged by simply acting within the law.”

26.68 The Treasury Board policies on travel and hospitality by deputy ministers and Governor in Council appointees, as well as the travel policies of entities that have the authority to establish their own, reflect the status of the individuals and the level of their responsibilities in government. However, the government clearly expects these individuals to use sound judgment when incurring expenses. It also clearly expects the entities to use sound judgment in establishing travel and hospitality policies that vary from those of the Treasury Board. It is not acceptable to use the discretion provided as a means of creating unreasonable entitlements to additional funds.

26.69 It should be noted that section 12 of the *Canada Labour Code* authorizes the payment of travel and other expenses subject to three conditions: the expenses must be “reasonable,” “incurred,” and take place while a board member is “absent from his ordinary place of residence in the course of his duties.”

26.70 Exhibit 26.2 presents the CLRB's travel per diem rates for board members from 1978 to March 1997. In January 1978, using the above authority, the Canada Labour Relations Board established its own travel policy for board members, which allowed a \$65 per diem for food and commercial accommodation. No receipts were required. In January 1986 the per diem was increased to \$125. In January 1987 an amendment of the policy deleted the requirement to use commercial accommodation in order to claim full per diem. The policy change allowed board members to claim the full per diem whether they stayed in private accommodation or commercial accommodation.

Exhibit 26.2

Canada Labour Relations Board Per Diem by Time Period

Time Period	Commercial Accommodation	Private Accommodation
Jan 78 - Sept 78	\$65.00	\$32.50
Oct 78 - Oct 79	\$70.00	\$35.00
Nov 79 - Feb 81	\$78.00	\$39.00
Mar 81 - Jan 82	\$90.00	\$45.00
Feb 82 - June 84	\$100.00	\$50.00
July 84 - Dec 85	\$115.00	\$60.00
Jan 86 - Dec 86	\$125.00	\$80.00
Jan 87 - April 88	\$125.00	\$125.00
May 88 - Jan 90	\$150.00	\$150.00
Feb 90 - Jan 91	\$170.00	\$170.00
Feb 91 - Mar 94	\$180.00	\$180.00
Mar 94 - Jan 97	\$180.00	\$80.00
Jan 97 - Mar 97	\$49.50*	\$47.50** \$13.50***

Notes

* plus hotel expenses

** includes meals and incidentals

*** allowance for private accommodation

26.71 The new policy stated:

For example, if the individual chooses to stay at the "Y" instead of in a commercial hotel and thereby minimizes accommodation expenses, that is his or her business and is not to affect the size of the payment of the per diem — and will not be questioned. Likewise, members or vice-chairmen using expensive facilities or incurring other expenses while away on Board business, which end up being more costly than the amount of the per diem, cannot expect reimbursement.

26.72 The current Chair was appointed in May 1989. In March 1994 he reinstated the requirement to use commercial accommodation to be able to claim the full per diem of \$180, and provided for a per diem of \$80 if private accommodation were used or if no accommodation were needed. These claims could be made without receipts being provided. This policy remained the same until January 1997 when the Board adopted the Treasury Board travel policies for public servants.

26.73 Throughout his tenure, the Chair has always claimed actual expenses incurred during business travel. He has relied on the Treasury Board policies on travel and hospitality for deputy ministers and Governor in Council appointees at levels 9 to 11 to make these claims.

26.74 The Treasury Board Secretariat's confirmation that the CLRB can make its own travel and hospitality compensation policies means that the Board can adopt the policies of the Treasury Board or vary them as it decides. However, the CLRB cannot vary the Treasury Board hospitality policy for hospitality expenses incurred when board members are in the area of their ordinary place of residence. Generally, the ordinary place of residence of board members is the National Capital Region.

26.75 We requested information from 52 comparable federal boards, commissions and councils on the travel and leave reporting policies for their Governor in Council appointees. Thirty-six entities have legislative authority for travel expenditures that is similar to section 12 of the *Canada Labour Code*. Only 6 of the 36 entities have established travel policies for their Governor in Council appointees that differ from the Treasury Board's travel policies.

Overall, the CLRB travel expense policy for board members was not reasonable

26.76 To assess the reasonableness of the CLRB's travel allowance policy for board members on accommodation, food and incidentals, we compared it with the policies of the Treasury Board and comparable entities. In January 1997 the CLRB, as a result of the internal audit, adopted the Treasury Board rates as a basis for payment of travel expenses.

26.77 In our opinion, the following elements of the CLRB's travel expense policies and practices for board members were not reasonable:

- during the period January 1987 to March 1994, board members were allowed to receive the \$125 to \$180 per diem while staying in private accommodation;
- commercial accommodation expenses were reimbursed without receipts;
- food and incidental expenses of \$80 were payable without receipts;
- payments for food have been made when meals have already been eaten before departure or served on airplanes or trains; and
- air travel points collected as a result of government business were not segregated from those obtained as a result of personal expenditures, and have been used for personal travel.

26.78 We also do not believe that the CLRB's policies were consistent with the provision of section 12 requiring that to be reimbursed, expenses must have been "incurred". Without receipts being provided, the CLRB could not ensure that expenses had been incurred. We note that in May 1994, Revenue Canada advised the Treasury Board Secretariat that if a fixed per diem travel allowance is "found to be unreasonably high" it may be taxable.

26.79 Until January 1997, the amount of the CLRB's per diem for board members was higher than that of most comparable entities. All of these entities require receipts for commercial accommodation. Members of provincial labour relations boards, with the exception of one board, are paid the same for travel expenses as public servants. Members of most of the similar boards at the national level in the United States, the United Kingdom, New Zealand and Australia are also paid the same for travel expenses as public servants.

Unreasonable past use of per diem by board members

26.80 During the period April 1989 to March 1994, the CLRB's per diem policy allowed board members to claim the full per diem, ranging from \$150 to \$180, whether or not they stayed in commercial accommodation. During this period about \$675,200 was paid in per diems to board members for travel expenses. Exhibit 26.3 compares CLRB policies with those of the Treasury Board and comparable entities on payments for travel expenses when staying in private accommodation.

Exhibit 26.3

Comparison of CLRB Allowances When Staying in Private Accommodation with Allowances for Public Servants and Governor in Council Appointees in Comparable Entities

	April 1989 to March 1994	April 1994 to 15 January 1997	January 1997 to March 1997
Canada Labour Relations Board			
Food and Incidentals	} \$ 150 - \$ 180	} \$ 80.00	\$ 47.55
Private Accommodation			\$ 13.50
Public Servants¹			
Food and Incidentals ²	\$ 38.95 - \$ 44.75	\$ 45.05 - \$ 47.55	\$ 47.55
Private Accommodation	\$ 13.50	\$ 13.50	\$ 13.50
GICs in comparable entities			
Food and Incidentals	\$ 38.95 - \$ 66.50	\$ 45.05 - \$ 66.50	\$ 47.55 - \$ 66.50
Private Accommodation	\$ 13.50 - \$ 18.00	\$ 13.50 - \$ 18.00	\$ 13.50 - \$ 18.00

Note

- 1 Public servants in government departments and agencies
- 2 Includes allowance for incidentals when staying in private accommodation

26.81 During the period April 1989 to March 1994, Governor in Council appointees in entities comparable with the CLRB received a total of \$38.95 to \$66.50 per day for food and incidentals and \$13.50 to \$18.00 to defray expenses for private accommodation.

26.82 In September 1990 the senior financial officer of the CLRB wrote to the Chair questioning the reasonableness of the CLRB's per diem policy with respect to private accommodation. Of specific concern was:

...the manner in which the per diem is administered when [Governor in Council appointees] travel and stay with family and friends. The [Treasury Board] approach would provide a token amount while the CLRB approach provides the full day per diem....It is argued that the per diem in this instance is a form of 'honorarium' to be used by the traveller as seen fit. Whatever the case, the practice is totally contrary to the government's approach and that of the Privy Council. The CLRB would be in a tight corner if its approach were to become public knowledge.

26.83 The December 1996 internal audit conducted by Human Resources Development Canada also concluded, "There is considerable evidence that the current per diem rate is not in line with [ensuring that travel is funded in the] most economical manner."

26.84 Because board members were not required to submit hotel receipts, we could not readily estimate the number of days that they stayed in private accommodation and received the full \$180 per diem. However, board members obtained a major benefit if they did not stay in commercial accommodation. This benefit may have been taxable.

CLRB policy on payment of per diems for food is not reasonable

26.85 The payments for food were paid to board members without taking into account the time of departure for a hearing or whether meals were served on flights. Deductions from the \$150 to \$180 per diem were not made for meals already taken or served on airplanes or trains. We estimate this practice resulted in about \$127,000 in additional payments based on Treasury Board meal rates for public servants. The six entities that have established their own travel policies deduct payments for meals already taken or served on airplanes or trains. The CLRB's September 1997 travel policy permits board members "to eat and claim for meals notwithstanding that a meal was served during their flight or train travel."

CLRB was advised to terminate its travel expense practices

26.86 The Vice-Chairs informed us that "all these [travel] expenses have been incurred, approved, and reimbursed in accordance with existing policies, all of which were known to government authorities and the Treasury Board in particular." However, the documentation that we reviewed indicates that government authorities did not approve of the CLRB's travel policies and that the authorities advised the CLRB to terminate its travel expense practices.

26.87 In March 1994 the Chair informed the Vice-Chairs that the "Treasury Board has made clear to this Board and to other organizations that the status quo will not be tolerated with respect to the current level of expenditures." As a result, he informed them he was revising certain CLRB financial practices, including travel policies for board members.

26.88 In April 1995 the Chair informed the Vice-Chairs that the per diem in effect at the CLRB for board members "is considerably higher than in effect elsewhere in the public service." He also informed them that "the auditors have expressed concerns that the Board pays out close to \$240K in expense per diems without any receipts" and that there was further concern that "a portion of the per diem amount which may exceed Revenue Canada guidelines on allowances for travel" may be taxable.

26.89 The Vice-Chairs informed us that they "have now reached an accommodation with the Chair with respect to [travel] expenses [in a manner] that is in accordance" with the July 1997 advice from the Treasury Board Secretariat. The agreement was reached on 15 September 1997.

Other Financial Concerns

Collection and use of air travel points is questionable

26.90 The Treasury Board Secretariat informed us that the government's policy on collecting air travel points applies to the CLRB. The Treasury Board policy permits the collection and use of air travel points for business purposes only under an overall departmental plan. In 1994, the Chair issued a policy stating that board members could not collect air travel points or must use any points collected for CLRB business travel. We found that some board members, including the Chair, had collected air travel points on government business travel and had neither declared them nor segregated them from air travel points collected on personal travel.

Other Questionable Payments

26.91 As indicated, we reviewed travel and hospitality expenses of board members during the period April 1989 to March 1997. We found instances of specific payments to board members that we believe are not consistent with

government financial rules. These payments included duplicate payments for meals, errors in recording of vacation leave, and commissions for sale and purchase of assets.

26.92 We reviewed the system for recording vacation leave. Until April 1996, leave taken was recorded manually by staff in the Chair's office rather than by the CLRB's administrative services. The CLRB has informed us that because there was no formal system for recording vacation leave or providing compensatory leave, some of the leave issues we raised could not be resolved. Errors due to clerical mistakes are being corrected. Certain of our other financial concerns had not been resolved at the time of writing.

26.93 Most comparable federal government entities have a formal system, administered by their human resources function, for recording vacation and compensatory leave of Governor in Council appointees. The CLRB adopted this practice in April 1996.

Accountability Needs to Be Improved

26.94 Members of the CLRB and similar quasi-judicial agencies must be able to make decisions independently of government as well as be perceived to be able to do so. The provision of legislative authority to make their own travel and hospitality policies is one of the institutional protections that support this independence. It protects members from being limited in hearing cases when travel expense allowances approved by the government are inadequate. However, the need for independence must be balanced by appropriate review procedures and accountability to Parliament.

26.95 **The government should propose legislation to Parliament containing guidelines for travel and hospitality expenditures by entities with the authority to establish their own policies for such expenditures.**

26.96 **The government should require that:**

- **entities that establish their own travel and hospitality policies publish for review by Parliament these policies and the resulting additional costs in comparison with Treasury Board policies for public servants; and**
- **the travel and hospitality expense claims of Governor in Council appointees in small agencies that establish their own travel and hospitality policies be reviewed and approved by a central financial function.**

Chair's Travel and Hospitality

Pattern of food and hospitality expenditures not reasonable

26.97 As we have indicated, the Chair claims reimbursement of actual travel and hospitality expenses. We found that the Chair's pattern of travel and hospitality expenses is not reasonable. The senior financial officer of the CLRB had questioned the appropriateness of the Chair's travel and hospitality expenses.

26.98 **Accommodation expenses.** Exhibit 26.4 presents the cost of the Chair's accommodation in comparison with that of public servants who travelled to the same location with a board member. Overall, the Chair's accommodation costs are significantly higher than those of public servants. For example, the Chair's accommodation cost per night in Canada during the period May 1989 to March 1996 ranged from \$59 to \$375. During this period, the accommodation costs of public servants at the same locations as the Chair ranged from \$52 to \$168.

Chair's Accommodation Expenses Compared with Expenses of Public Servants in the CLRB

	Range of Expenses	
	Chair	Public Servants in CLRB
A. Canada		
May 1989-March 1996	\$59 - \$375	\$52 - \$168
April 1996 - March 1997	\$84 - \$328	\$71 - \$216
B. Europe		
May 1989-March 1996	\$130 - \$717	n/a
April 1996 - March 1997	\$485 - \$515	n/a

n/a Not applicable. CLRB public servants did not travel to Europe.

26.99 Food expenses. Exhibit 26.5 presents the Chair's food expenses in North America when hospitality was not extended. From his appointment on 1 May 1989 to 31 March 1997, the Chair claimed a total of \$70,700 for about 1,400 meals in North America. During this period, a public servant could claim from \$6.70 to \$8.80 for breakfast expenses; the average claimed by the Chair for breakfast is \$16.86. For lunch a public servant could claim from \$8.50 to \$9.40; the average claimed for lunch by the Chair is \$38.56. For dinner a public servant could claim from \$19.75 to \$25.00; the average claimed for dinner by the Chair is \$91.13. The Chair submits only credit card slips or one-line total expenses on a hotel bill.

Exhibit 26.5**Chair's Food Expenses When Hospitality Not Provided Compared with Treasury Board Allowances for Public Servants**

(May 1989 to March 1997)

A. Cost of Meals	Chair¹	Public Servants²
Breakfast	\$17	\$6.70 - \$8.80
Lunch	\$39	\$8.50 - \$9.40
Dinner	\$91	\$19.75 - \$25.00
B. Cost of Meals	Occasions	Cost
Total Meals:	1,400	\$70,700
Above TB rates	1,300	\$51,000
100% above TB rates	1,050	\$42,400

¹ Average cost of meals

² The range of allowances allowed for public servants during period May 1989 to March 1997 under Treasury Board policies

26.100 If the Chair had been subject to the Treasury Board rules for public servants, his claims for the meals would have been about \$19,400 rather than \$70,700. The cost of about 1,050 of these meals exceeded Treasury Board rates by 100 percent or more, for an incremental cost of about \$42,400.

26.101 Hospitality expenses. The Privy Council Office’s summary of the Treasury Board policy on hospitality expenditures states:

Expenditure of public money for hospitality is strictly limited to initiatives that facilitate operational objectives or comply with the requirements of courtesy or protocol. Generally, hospitality expenditures are reimbursed only when recipients are not government employees and the occasion marks important meetings, conferences and ceremonies.

26.102 The Chair claimed hospitality expenses on 564 occasions, for lunch and dinner in North America during the period 1 May 1989 to 31 March 1997, for a total of about \$74,400. During this period, public servants were allowed to spend, on an unusual and non-recurring basis, a maximum of \$25.50 to \$28.20 per person for lunch, and from \$51.84 to \$65.63 per person for dinner. The Chair’s average per person lunch hospitality cost was about \$46 and his average per person dinner hospitality cost was about \$93. Exhibit 26.6 presents the Chair’s hospitality expenses in North America.

Exhibit 26.6

Chair’s Hospitality Expenses in North America Compared with Maximum Treasury Board Allowances
(May 1989 to March 1997)

Cost of Hospitality	Chair ¹	Public Servants ²
Lunch	\$46	\$25.50 - \$28.20
Dinner	\$93	\$51.84 - \$65.63

¹ Average cost of hospitality

² The range of maximum hospitality allowances, on an unusual and non-recurring basis, for public servants during the period May 1989 to March 1997 under Treasury Board policies

26.103 The Chair’s hospitality expenses exceeded the maximum Treasury Board per person lunch and dinner hospitality rates allowed public servants by more than 100 percent on 132 occasions. The total cost for the 132 occasions was about \$24,900. The portion of the cost resulting from the Treasury Board rates being exceeded by more than 100 percent was \$15,100.

26.104 The Treasury Board hospitality policy applies to the Chair in the National Capital Region, his ordinary place of residence. In this Region the Chair spent about \$29,000 on hospitality, primarily on lunch with certain CLRB public servants and board members. The average per person lunch hospitality cost was about \$45. As noted above, the maximum lunch hospitality allowance for public servants ranged from \$25.50 to \$28.20.

26.105 During the period June 1991 to March 1996, the Chair travelled to Europe and spent about \$3,690 on hospitality. The average per person cost for lunch was about \$180; the average per person cost for dinner was about \$195.

26.106 Review by Ethics Counsellor. The Prime Minister requested that the Ethics Counsellor review allegations that the Chair may have met improperly with a number of railway management representatives during hearings before the Canada Labour Relations Board during 1990-92. In July 1997, the Minister of Labour stated in a press release that the Ethics Counsellor had found “no substance to the allegations of impropriety but was concerned that the CLRB lacks written procedures outlining appropriate behaviour for board members in their dealings with company and union representatives when hearings are underway.” The Ethics Counsellor “strongly recommended that the CLRB establish written guidelines as soon as possible.” The Minister “accepted the Ethics Counsellor’s

conclusions and strongly endorsed his recommendation that guidelines be established..." At the time of writing, these guidelines had not yet been developed.

26.107 The Chair mixes personal and government collection and use of air travel points. The Chair provided us with information on air travel points collected and used. The Chair states that he has collected and used a significant number of air travel points for personal and government business since being appointed to the Board in May 1989.

26.108 The air travel points collected by the Chair as a result of government business travel were not declared and segregated from those collected as a result of private travel. Therefore, we could not verify the specific amount of air travel points earned as a result of government travel and used by the Chair. The Chair explained that he used the air travel points resulting from government travel for spousal representational purposes at events in other countries. Since the Chair did not obtain the required approval from the Minister of Labour for the representational function, we believe that the Chair's authority to use the points for these purposes is questionable.

26.109 Non-business use of government telephone calling card and taxi chits. We found that the Chair's government telephone calling card and taxi chits had been used for non-business purposes. As a result of our audit the Chair has reimbursed the government a total of about \$1,900 for the taxi and telephone calling card expenditures.

26.110 Recording of Chair's vacation leave is inaccurate. We found that about 36 days of leave that the Chair took or was paid for were not recorded in his leave records in his office. The senior financial officer of the CLRB has confirmed our observations and the Chair is reviewing his records.

26.111 Expenses for National Academy of Arbitrators. The Chair has been an official of the National Academy of Arbitrators, including President, for several years. The Chair attended 28 meetings involving the Academy. The total cost paid by the Board for these trips is about \$53,200, excluding costs directly associated with conferences. His average accommodation cost per night was about \$280. About \$7,000 was spent on hospitality; the average per person hospitality cost was about \$130. The National Academy of Arbitrators informed us that as a general practice the expenses incurred by its officers are paid by the officers themselves, by their employers, or by other parties.

Canadian Labour Relations Board's response: The [chapter] is essentially accurate in its account of the history of internal conflict at the Board, and with respect to its failure to achieve acceptable productivity and efficiency in its adjudicative work. There have, however, been substantial achievements in the administration of this institution during my term. These include the successful reduction in the Board's budget by more than 15 percent and the reduction in head office administration by 25 percent at a minimum cost in human terms; the recent setting of performance standards in operations and adjudications and other initiatives... as well as the completion, over the past few years, of major cases involving national employers and requiring massive revision of bargaining unit structures across Canada.

The [chapter] makes a number of recommendations (in paragraphs 26.43; .49; .58; .64; .95 and .96). These would affect both the adjudicative and financial administration of the Board. I agree with these recommendations. Each of them embodies or is consistent with a change which I have sought to have accepted since shortly after my arrival at the Board. Had I been able to carry out these changes the Board's performance could have been improved dramatically. I have had little support in this effort. I welcome the changes that are contained in the proposed legislation.

The [legal] expenses to which the [chapter] refers were paid to various counsel over a considerable period of time to obtain clarification of the authority of the Chairman as Chief Executive Officer in the adjudicative administration of the Board. The expenditures were made to rationalize and improve the Board's operations. As the [chapter] notes, there has been a systemic failure at the Board for a very long period of time. I inherited the situation, I

sought to change it, and I met resistance. Legal advice to me in my capacity as Chairman of the Board was essential.

The legal advice which I obtained was not for my “private” defence. It was not covered either by the terms or the intent of the government’s policy. The Vice–Chairs resorted to litigation. It did not proceed. The “ex gratia” payment in respect of legal costs incurred by Vice–Chairs was part of a “settlement” reached in the public interest with the aid of a mediator in order to put an end to job actions being taken by the Vice–Chairs, one of whom had even refused to handle an urgent unlawful strike application. The mediation process was put in motion by the then Minister of Labour. The Board co–operated with the mediator and the process.

In the [chapter] ... the “conclusion” is stated that “the Chairman’s pattern of expenditures on travel and hospitality is not reasonable”. I do not accept that the expenditures were unreasonable.

I agree that the standard to be applied is one of “reasonableness”. It is clear that a broad discretion exists in the case of a deputy head. This is clear both from the legislation and all applicable regulations. The [chapter] itself recognizes the special status of the deputy head position. Unreasonableness must be determined by reference to the responsibilities and functions of the Chairman of the Canada Labour Relations Board.

The work of the Chairman has three main aspects. First, he or she has an overall responsibility for the adjudicative operations of the Board (the extent of which has been the subject of great conflict), as well as a responsibility in the hearing and decision of certain cases before the Board. Actual hearing of cases has involved considerable and at times lengthy travel, the Board’s geographical jurisdiction involving all of Canada. My own rate of participation in the hearing and deciding of cases is among the highest at the Board. On some occasions (see, for example, paragraph 26.106), hospitality expenses may be required.

Second, the Chairman as Chief Executive Officer and as deputy head of the department has administrative duties relating to a department which has offices in Ottawa and in five other locations across Canada. These responsibilities likewise involve considerable travel and, to some degree, hospitality.

Third, there is a more general role of leadership within the labour relations community, both within and outside of Canada. The Chairman is, in an informal way, an ambassador for Canada, and represents Canada at international conferences. My expenses were in line with the expenses of other participants attending such conferences.

Reciprocal international conferences have been held in Canada with substantial intellectual and economic benefit to the country. These have included the hemispherical conference of the International Society for Labour Law and Social Security held in Montreal in 1995, and two conferences of the National Academy of Arbitrators (in Ottawa in 1990 and in Toronto in 1996 — when I was President of the Academy). The holding of the latter two in Canada has been primarily due to my efforts in this aspect of my work.

To state, as the [chapter] does, that expenses incurred in carrying out the duties of Chairman of the Board are unreasonable because they are substantially in excess of the Treasury Board regulations governing the expenses of public servants (regulations which clearly do not apply in the case of deputy heads), is wrong. The appropriate standard of comparison is not to public servants generally, but to public officials having the same status and performing the same or similar functions as the Chairman of the Board. The comparisons used in the report do not provide an appropriate basis for the assessment of my expenses, which in my view were appropriate to the circumstances.

(This response was provided by the Chair of the Canada Labour Relations Board.)

About the Audit

Objective and Scope

The objective of our audit was to determine whether:

- the travel, allowances and benefits reimbursed to the Chairman and the board members were in accordance with relevant legislation and policies of the government and the Canada Labour Relations Board (CLRB);
- the policies of the Treasury Board are clear; and
- the payments made to board members, including the Chair were reasonable.

We examined travel, allowances and benefits policies of the CLRB. For the period April 1989 to March 1997 we audited the reimbursements to the Chairman, current board members and certain former board members since the appointment of the current Chairman. We examined a range of payments, including those for leave, hospitality, hotels, meals, conferences, automobile travel, legal advice, airfare, travel to and from ordinary place of residence, the collection of frequent flyer points and salary per diem payments to former members.

We compared the CLRB's practices with those of other federal boards, commissions and councils with Governor in Council appointees. We did not audit the travel claims of the Governor in Council appointees in these agencies. We also compared the CLRB's practices with those of provincial labour boards, and with similar labour boards in the United States, the United Kingdom, Australia and New Zealand.

The CLRB has been the subject of major recent reviews, including the 1996 report of the Task Force on Part I of the *Canada Labour Code*. These reviews have consistently found similar organizational and performance problems. The purpose of this audit was not to redo the work of these reviews. Rather, we relied on them to identify the underlying causes of the financial problems we were examining. We report those matters that needed to be brought to the attention of Parliament at this time.

We did not examine the travel expenditures of public servants employed by the CLRB. The Treasury Board travel policies govern travel by public servants employed by the CLRB.

Audit Team

Christina Brooks
John Cathcart
Estelle Charette
Camille Gilbert
Jean-Marc Lafrenière
Sue Morgan
Gaëtan Poitras
Peter Sorby
Tony Shaw

For information, please contact Alan Gilmore, the responsible auditor.

Chapter 27

Ozone Layer Protection: The Unfinished Journey

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Ozone Layer Protection: The Unfinished Journey

Commissioner of the Environment and Sustainable Development: Brian Emmett

Responsible Auditor: Wayne Cluskey

Main Points

27.1 Because of its northern location, Canada is one of the countries most at risk from the effects of ozone layer depletion, considered one of the most serious global environmental issues to confront humankind. It poses major threats to human health and ecosystems.

27.2 The problem of ozone layer depletion has not been solved. The full recovery of the ozone layer is not predicted for at least 50 more years, assuming full implementation of the *Montreal Protocol*, an international treaty signed by more than 160 countries and aimed at eliminating ozone-depleting substances (ODS).

27.3 Canada has met or exceeded its obligations under the *Montreal Protocol* in each year since it came into effect, according to data compiled by Environment Canada. Canada has also provided assistance to developing countries in their efforts to eliminate ODS. Foreign government officials and experts see Canada as having played a pivotal role in the early development and ongoing evolution of the *Montreal Protocol*.

27.4 Effective enforcement of federal ODS regulations under the *Canadian Environmental Protection Act (CEPA)* is necessary to ensure that phase-out commitments are fulfilled and reported with confidence, as well as to curb illegal trafficking of ODS. We observed several weaknesses in Environment Canada's overall inspection function for ODS regulations under *CEPA*, and believe it is insufficient to ensure compliance with the regulations.

27.5 Canada was among the first countries to put in place a national regime for the recovery and recycling of chlorofluorocarbons (CFCs) aimed at reducing emissions of ODS to the atmosphere, through the implementation of a federal-provincial 1992 National Action Plan. Many of the tasks included in the Plan have been accomplished, including the implementation of regulations in 9 of 10 provinces and the training of more than 75,000 service technicians.

27.6 However, there are significant weaknesses in the Plan, including differences in the requirements among the provincial regulations, and gaps in the measurement of the Plan's results, benefits and costs. These weaknesses underscore the complexities involved in managing a federal-provincial partnership and highlight the need for improved federal government accountability in this regard.

27.7 Public awareness of ozone depletion is high, due in part to sustained educational efforts by federal departments. Recent surveys show that half of all Canadians do not adequately protect themselves during leisure activities. The potential health consequences and costs to the Canadian public should not be ignored.

27.8 Federal departments are substantial users of ODS. Departments we surveyed have implemented strategies to manage their ODS. But they have not met government commitments to lead by example. The federal government has failed to set direction and articulate its expectations for leadership and it has not assigned responsibility to any department for doing this. In effect, no department is in charge.

27.9 If proposed *CEPA* regulations for ODS management at federal facilities are implemented in their current form, and in the absence of any other directive from the federal government, gaps in direction will remain in areas

such as phase-out target dates for all ODS applications, the management of stockpiles, ODS conversion to, or replacement with, environmentally acceptable alternatives, and the destruction of surplus ODS. We are also concerned that Environment Canada may lack the capacity to enforce the proposed regulations.

27.10 Ozone layer protection programs in developed countries, including Canada, have lost momentum. Opportunities exist for the federal government to speed the recovery of the ozone layer. Environment Canada has demonstrated an awareness of many of these opportunities. But we believe it needs to set priorities among competing actions, based on sound science and a comparison of their relative costs and effectiveness in reducing risks. Canadian leadership is arguably needed now more than ever before.

Introduction

27.11 Ozone layer depletion is considered to be one of the most serious global environmental and human health threats we have ever faced.

27.12 Efforts to understand and solve this problem are already a quarter of a century old, yet much work remains to be done at home and abroad before success is achieved. Our grandchildren, and possibly their children, will have to cope with the legacy of ozone layer depletion we leave to them.

27.13 Ozone layer protection is a story of determination and achievement. Over 160 countries have united to eliminate the production of chemicals that destroy ozone. Successes to date have been achieved through managed relationships among science, diplomacy, policy making and industrial ingenuity. They provide evidence that solutions to complex global issues demand co-operative efforts from all sectors of society and all corners of the world, and that, through dedication, solutions can be found.

Ozone Layer Depletion

27.14 **The Earth's stratospheric ozone layer is crucial to life on Earth.** It protects living things from the harmful effects of the sun's ultraviolet radiation. Located 15 to 35 km above the Earth's surface, the ozone layer absorbs all but a small fraction of harmful ultraviolet radiation emanating from the sun.

27.15 Today there is scientific consensus that manufactured chemicals, known as "ozone-depleting substances" (ODS), are responsible for depleting the ozone layer. Although ODS are chemically stable in everyday use, once they reach the stratosphere they are broken apart to release chlorine and bromine atoms, the active ingredients that destroy ozone. Ozone depletion results in increased levels of ultraviolet-B (UV-B) radiation at the Earth's surface. The process of ozone layer depletion is depicted in Exhibit 27.1

Exhibit 27.1 Nature and Uses of Ozone-Depleting Substances

Ozone-depleting Substances	Ozone-depleting Potential Range	Canada's Phase-out Date	Lifetime in Atmosphere	Commercial Uses
Halons	3.0 to 10.0	January 1, 1994	up to 65 years	in fire-extinguishing equipment and systems
Carbon Tetrachloride	1.1	January 1, 1995	up to 42 years	"chemical feedstock" in the production of CFCs, fire extinguishers, dry cleaning agent, and as an ingredient in pesticides, pharmaceuticals, paints and solvents
CFCs	0.6 to 1.0	January 1, 1996	between 50 and 1,700 years	propellant in aerosols, coolants in refrigerators and air conditioners, solvents in degreasers and cleaners, foam-blowing agent
Methyl Chloroform	0.1	January 1, 1996	6 years	solvent in cleaners, degreasers and adhesives
Methyl Bromide	0.6	January 1, 2005 ²	up to 2 years	pesticide used in soil fumigation and fumigation of some food production facilities, in some transportation and

				quarantine applications, related to the export and import of food and other agricultural products
HCFCs ³	0.001 to 0.52	January 1, 2020	up to 19 years	foam blowing, refrigeration and air conditioning, solvent cleaning and, to a lesser extent, aerosols and fire protection

¹ Each substance has a different effect on the ozone layer, and is measured using a standardized reference known as its ozone-depleting potential (ODP)

² Although CEPA ODS regulations currently indicate a phase-out date of January 1, 2010, at the ninth meeting of the parties to the *Montreal Protocol* the parties, including Canada, agreed to a phase-out of methyl bromide by January 1, 2005 for developed countries.

³ Most HCFCs have been developed for use as transitional chemicals to replace the more damaging ozone-depleting substances, mainly CFCs.

27.16 Because of its northern location, Canada is one of the countries most at risk from the harmful effects of ozone depletion. By 1997, the ozone layer over the midlatitude regions of Canada has been depleted by as much as 7 percent averaged over the entire year, compared with pre-1980 levels. This has been accompanied by an increase in ultraviolet-B radiation of approximately 8 percent.

A major human health and environmental threat

27.17 The risks to human health from ozone depletion are substantial. UV-B radiation causes melanoma and other skin cancers in humans. A portion of the observed threefold increase in melanoma cancer rates in Canada between 1969 and 1992 is believed to be the result of ozone depletion. It is estimated that in 1997, 61,000 Canadians will develop skin cancer; 3,200 will have melanoma. Of these, 660 are expected to die as a result. Other potential health risks are related to eye diseases and to immune system deficiencies.

27.18 Analyses by Environment Canada suggest that the successful implementation of existing federal regulations will result in future health benefits and savings worth billions of dollars.

27.19 Increased UV-B radiation also affects the growth of plants, has the potential to disrupt the biodiversity of terrestrial ecosystems, and is harmful to aquatic ecosystems.

A Global Problem: A Global Response

27.20 Emissions of ODS do not respect geographic or jurisdictional boundaries. The ozone layer over Canada is affected as much by emissions from abroad as by emissions at home. This means that unilateral action by one country will have little impact on ozone recovery. Conversely, inaction by one or more countries undermines the efforts of all others. Actions to solve ozone depletion must continue to be undertaken on a global scale, by all nations.

27.21 The worldwide production and use of ODS grew steadily until the late 1980s. Considered safe, reliable, versatile and cheap, ODS came to form part of the fabric of modern society. Until recently, they were used extensively in the manufacturing of industrial and consumer products such as foams and electronic equipment, and were contained in thousands of end-use applications and consumer products, such as refrigerators, fire extinguishers and medical devices. The nature and uses of ozone-depleting substances are illustrated in Exhibit 27.2

Exhibit 27.2

(This exhibit is not available, see the Report)

The Vienna Convention

27.22 Scientists first expressed the concern that human activities were causing destruction of the ozone layer in the early 1970s. This concern led to the signing in 1985 of the *Vienna Convention for Protection of the Ozone Layer*, negotiated under the auspices of the United Nations Environment Program (UNEP). The *Vienna Convention* committed its signatories to co-operate in areas of scientific investigation and, more important, laid the foundation for future controls. At the time it was negotiated, there was considerably more scientific uncertainty and industrial opposition than exists today. For this reason, the *Vienna Convention* is often considered to be the world's first acceptance of the "precautionary principle": nations agreed to tackle an issue before its effects were felt or its existence was scientifically proven.

The Montreal Protocol

27.23 In September 1987, 24 countries signed the *Montreal Protocol on Substances That Deplete the Ozone Layer*. It has since been ratified by more than 160 countries. The *Montreal Protocol* reflects a determination to protect the ozone layer by taking precautionary measures to control substances that deplete it, and ultimately to eliminate them. The *Montreal Protocol* controls the production, import and export of new ODS. It does not control the use of ODS in such applications as manufacturing or equipment, nor does it control emissions to the atmosphere. Features of the *Montreal Protocol*, including the existing ODS phase-out schedule, are described in Appendix A.

27.24 The *Montreal Protocol* broke new ground in many areas and is often hailed as a model for solving environmental issues of a similar nature. Many factors have contributed to its success to date, including:

- a strong scientific basis, supported by major scientific assessments on ozone depletion, undertaken at the UNEP level;
- binding, measurable reduction schedules, which apply equally to all developed countries;
- special provisions for developing countries, based on the principle of mutual but differentiated responsibilities, such as a grace period for phase-out of ODS and direct financial assistance through the Multilateral Fund (described in Appendix B); and
- incentives to encourage participation by all countries through mandatory trade controls against non-parties.

Some lessons learned in the global ozone layer protection experience are presented in the Special Insert on page 27-18.

27.25 The *Montreal Protocol* is a living treaty, with built-in provisions for making changes on the basis of new scientific information and technological developments. The control regime established in 1987 has since been modified on several occasions, both by adding new substances to the regime and by accelerating the phase-out schedules for existing ones. Over 90 individual ozone-depleting substances are now controlled under the *Montreal Protocol*.

27.26 The *Montreal Protocol* has been remarkably successful in achieving its objectives to date. From peak production levels of nearly one million tonnes of CFCs per year in 1986, new production of CFCs ceased in most

developed countries by 1996 (with the exception of small quantities for uses deemed essential). The results for halons are even more impressive: in developed countries, phase-out of new production was achieved by 1994.

27.27 Technically, economically and environmentally acceptable alternatives have been developed for the vast majority of applications of CFCs and other ODS. However, there are some applications for which permanent acceptable alternatives have yet to be found. The conversion within industry to ozone-friendly technologies and processes resulted, in some cases, in economic savings and improved product performance. To date, this conversion has been largely invisible to most Canadians -- but it is also incomplete. For example, the expensive and inconvenient task of dealing with ODS in older household refrigerators and car air-conditioners has yet to come.

An Unfinished Journey...

27.28 Scientists predict that it will be at least 50 more years before the ozone layer fully recovers, assuming complete implementation of the *Montreal Protocol* and its amendments by all signatory nations. Unfortunately, this has not yet been achieved. Nor will it be, in our opinion, without the sustained, even accelerated, efforts of leading nations such as Canada. Despite achievements to date, the journey to repair the ozone layer is far from over and success is far from assured.

27.29 Sources of emissions of ODS, and other conditions, have shifted dramatically since the *Montreal Protocol* was first negotiated, and particularly since CFC phase-out in developed countries was completed in 1996. New challenges are confronting governments around the world:

- Controls on hydrochlorofluorocarbons (HCFCs) and methyl bromide will be required for decades to come.
- Developing countries now represent the largest threat to ozone layer recovery: their production and use of CFCs and halons has grown in recent years and is still increasing. Despite substantial financial assistance provided to date through the Multilateral Fund, many have already signaled anticipated difficulties in complying with the *Montreal Protocol*.
- Some countries with economies in transition are also experiencing difficulties in meeting their obligations.
- Substantial quantities of new and used CFCs and halons are contained in existing equipment or being stored for future use. Unless destroyed, or converted to other substances, they are destined for release into the atmosphere.
- In developed countries, CFCs and halons are scarce and valuable commodities; there is a demand for these substances to service existing equipment dependent on them, such as in refrigeration, air-conditioning and fire suppression systems. The *Montreal Protocol* does not currently prevent the international trade of used or recycled ODS. This has given rise to a black market trade in ODS whereby newly produced substances are sold as used or recycled substances.

27.30 Because of these changes in conditions, this is an important juncture in the evolution of global and Canadian efforts to protect the ozone layer. Strategies that worked well over the past decade need to be critically examined and adjusted to meet the needs of future decades. Opportunities exist to ensure full implementation of the *Montreal Protocol* in developed and developing nations and to speed the recovery of the ozone layer. Canadian leadership in capitalizing on these opportunities is arguably needed now more than ever before.

Focus of the Audit

27.31 The focus of our audit was on Canada's implementation of the *Montreal Protocol* and other controls on ODS. The chapter first examines the implementation of the federal regulatory framework under the *Canadian Environmental Protection Act (CEPA)* for achieving the commitments made in the *Montreal Protocol*. It then assesses the activities in areas of joint federal–provincial responsibility through the development and implementation of the 1992 National Action Plan. We also address the extent to which federal departments have implemented measures to “green” their own operations with respect to ozone–depleting substances. We also point to lessons learned in the global ozone layer protection experience. Audit objectives, criteria and approach are described in detail at the end of the chapter in **About the Audit**.

Observations and Recommendations

Canada in a Global Context

A legacy of contributions

27.32 For over two decades, Canadians have been at the forefront of efforts to address ozone depletion, and have united to develop a domestic and international control regime that accommodates a range of competing interests.

27.33 Such efforts have been linked to and combined with those of other countries, numerous United Nations agencies and other international organizations, and expert Assessment Panels. Foreign government officials and experts see Canada as a pivotal player in the early development and ongoing evolution of the global response to ozone layer depletion. Some hold the view that the *Montreal Protocol* would not exist in its current form had it not been for the leadership and intervention of Canadians. Some illustrations of Canadian global contributions are given in Exhibit 27.3

Exhibit 27.3

(This exhibit is not available, see the Report)

Canada's regulatory and policy framework

27.34 The federal government's efforts in this field encompass many activities. Environment Canada is the lead federal department. It is active in areas such as international negotiations, implementing and enforcing *CEPA* regulations, scientific research and monitoring, public education, and providing assistance to developing countries. Environment Canada acts as a partner and works co–operatively with several other federal departments, other levels of government in Canada, industry, academia, non–government environmental and health organizations, and the public.

27.35 Canada first regulated CFCs in 1980, when it banned their use as aerosol propellants in a variety of toiletry items and other consumer products. The *Montreal Protocol* was subsequently implemented through a series of ODS regulations made under the *CEPA*.

27.36 Provinces have also regulated end–use applications and recycling of ODS. Such regulations were not required by the *Montreal Protocol*. These regulations were co–ordinated through the 1992 National Action Plan on Recovery, Recycling and Reclamation of CFCs, issued by the Canadian Council of Ministers of the Environment's (CCME).

27.37 The federal government has also promoted the use of non-regulatory measures in its own operations, including commitments to green its operations as contained in the 1995 *Guide to Green Government*.

Meeting Our International Commitments

27.38 Overall, Canada's accomplishments under the *Montreal Protocol* compare favorably with, and in several instances exceed, those of other countries.

Implementation through *CEPA* regulations

27.39 Control of ODS. According to data compiled by Environment Canada, Canada has met, and in some cases exceeded, its obligations to control ODS under the *Montreal Protocol* each year since it came into effect. Canada's accomplishments for CFCs, halons, HCFCs and methyl bromide are illustrated in Exhibit 27.4. In many cases, phase-out dates enacted under *CEPA* were more stringent than required by the *Montreal Protocol*. Also, Canada's actual consumption was often significantly lower than the maximum allowed it under the *Montreal Protocol*. Controls on HCFCs and methyl bromide will be required in Canada for several more decades.

Exhibit 27.4

(This exhibit is not available, see the Report)

27.40 Trade bans. The *Montreal Protocol* requires parties to ban imports and exports of ODS and certain products containing ODS from and to nations not party to it. Canada has issued the required trade bans.

27.41 Reporting of data. Parties are required to submit data yearly to the United Nations Environment Program (UNEP) on their production, imports, exports, destruction and recycling of controlled substances. Complete and timely data reporting is a chronic problem within the *Montreal Protocol*, and many countries do not fulfil their obligations. Canada has duly reported its data to UNEP.

Effective results measurement and solid policy foundations

27.42 Many factors were critical to Canada's successes in influencing and implementing the controls under the *Montreal Protocol*. Such factors included ongoing measurement of results achieved, scientific, technical and cost-benefit justification, and effective stakeholder consultation.

27.43 Results measurement. Results must be measured against stated program objectives if needed changes are to be identified and future directions set. *CEPA* ODS regulations made use of clear and precise phase-out targets, like those contained in the *Montreal Protocol*. Coupled with an infrastructure for collecting and analyzing data on the production and trade of ODS, this facilitated a relatively straightforward measurement of the results achieved. Supported by monitoring of atmospheric bromine and chlorine levels, such measurements strengthened Environment Canada's position in advocating the need for additional controls on ODS and implementing them.

27.44 Scientific foundations. Controls enacted under *CEPA* were science-based, drawing on the UNEP science assessments. Environment Canada also conducted extensive research, monitoring and reporting the ozone-related trends and impacts in Canada. Together, these scientific investigations mobilized Canadian industry and public support for the *Montreal Protocol* objectives and accompanying *CEPA* ODS regulations.

27.45 Technical and socio-economic analysis. Controls enacted under the *Montreal Protocol* were also supported by regular major UNEP assessments of the state of technology and economics. *CEPA* ODS regulations

were developed using this information and were also subjected to analysis of costs, benefits and technical feasibility. At least 17 separate studies have been conducted during the life of the program.

27.46 Stakeholder consultations. Environment Canada regularly consults with affected stakeholders regarding various elements of the ozone protection program, including the content of *CEPA* regulations, non-regulatory initiatives, and international negotiating positions. Stakeholders interviewed in the course of our audit expressed a high level of satisfaction with the extent of consultation and the degree of sensitivity to their needs and concerns. Agriculture and Agri-Food Canada has supported a similar consultation process with the methyl bromide stakeholder community, and has worked with industry to demonstrate alternatives. This consultation has fostered industry and public support for the control initiatives and, in our opinion, was important to the successful achievement of the *Montreal Protocol* objectives.

Funding commitments being met and results achieved through bilateral assistance

27.47 Canada currently contributes approximately US \$5.7 million per year to the Multilateral Fund. Canada met its funding obligations in the period from 1990-1993 and the bulk of its obligations from 1994-1996, although a portion is unpaid for this latter period. Canada's cumulative contribution to date is approximately US \$30 million. Responsibility for making Canada's contribution to the Multilateral Fund is shared between Environment Canada (20 percent) and the Canadian International Development Agency (80 percent). This is a long-term funding obligation that will continue for many years to come.

27.48 Donor countries to the Multilateral Fund may make up to 20 percent of their contributions in the form of country-to-country bilateral assistance projects, matching their technologies and expertise with the needs of developing countries. Environment Canada has been a leader in implementing such projects. These projects have played a constructive role in helping recipient countries to meet their *Montreal Protocol* obligations. They have also supported Canada's foreign policy objectives and provided opportunities for the growth of Canadian environmental industries.

27.49 Other donor countries are increasing their attention to bilateral assistance projects; one country we surveyed has four full-time employees dedicated to its bilateral assistance programs. Environment Canada's bilateral assistance efforts have no full-time staff, which suggests to us that they are viewed by senior management in the Department as a discretionary, not strategic, component of the Department's efforts to preserve the ozone layer.

27.50 In our opinion, bilateral assistance projects represent a "win-win" situation for Canada, recipient countries and the ozone layer. We believe that Environment Canada could build on successes to date by formalizing its efforts to promote bilateral assistance projects and by strategically engaging other organizations, such as the Canadian International Development Agency, to capitalize on their networks, activities and expertise.

Weaknesses in the enforcement of *CEPA* regulations

27.51 Effective enforcement of ODS regulations is pivotal to ensuring that commitments to the *Montreal Protocol* are met, particularly in light of ongoing and long-term obligations to control HCFCs, methyl bromide and used CFCs and halons. It is also essential to curb ODS smuggling operations in Canada. Although the full extent of this problem in Canada is not known, recent joint Canadian-U.S. investigations that have led to prosecutions on both sides of the border indicate that the activity is real.

27.52 Inspection of regulated companies is the main instrument used by Environment Canada to achieve two objectives: assurance of the accuracy of data reported to UNEP, and compliance by companies subject to *CEPA* ODS regulations. Environment Canada's regional offices have a high degree of autonomy in determining their

inspection plans and carrying out their inspection program, while headquarters is responsible for setting general direction and co-ordinating regional efforts. We observed several weaknesses in Environment Canada's overall inspection regime for *CEPA* ODS regulations, including inconsistent identification of the regulated community, an unclear planning process for determining which companies to inspect, and inconsistent inspection coverage of the regulated community. At present, this inspection regime is insufficient to ensure compliance with the *CEPA* ODS regulations.

27.53 Inconsistent identification of regulated community. Companies potentially subject to inspections include those that have been granted permission under *CEPA* to import, export or manufacture ODS (they are required to report data to Environment Canada) as well as others that may be engaged in the import or export of new or used ODS. Environment Canada's regional offices do not use a consistent approach to identify the companies subject to inspections. Some regions use only a list of permitted companies provided by headquarters, others use data collected by Revenue Canada–Customs, and others inspect companies in market sectors that use ODS. In practice, companies that conduct the same activities in more than one region may be subject to inspections in one region but not in others.

27.54 Unclear planning process. Environment Canada's *Enforcement and Compliance Policy* requires that the schedule of inspections be determined by the risk the substance or activity presents to the environment or to human health, and by the compliance record of the individual, company or government agency. Our audit found no evidence that these or any other criteria were applied consistently from region to region. Furthermore, Environment Canada has not determined the level of inspection coverage necessary to ensure compliance with the ODS regulations and to verify the accuracy of data reported to UNEP.

27.55 Inspections of permitted companies. These weaknesses have led in turn to gaps and inconsistencies in inspection coverage. Of the 174 operations with permission to import, export or produce ODS in Canada, 108 are farmers or companies who import small quantities of methyl bromide, and others who have transferred their consumption allowance to authorized importers. Very few of these have been inspected. Nationally, fewer than 20 percent of the remaining companies have been inspected by Environment Canada in the past three years, although there are wide variations in the inspection coverage from region to region. For example, 8 of 16 companies with ODS permits in the Pacific and Yukon Region were inspected in that period, while only 2 of 31 companies in Ontario were inspected. Many of the Ontario companies have never been inspected.

27.56 Inspections of non-permitted companies. Various sources can be used to identify non-permitted companies subject to inspection; one source is data collected by Revenue Canada–Customs, which tracks imports on a shipment-by-shipment basis. In some regions, these data are used as a primary source for inspections, while in others they are rarely used. In 1996, for example, Customs data identified 49 Ontario companies importing over 10 kilograms of ODS that did not have a permit to do so; only one of these has been inspected by Environment Canada in the past three years. Many of these companies reportedly have imported thousands of kilograms of ODS, but Environment Canada has neither inspected them nor followed up with Revenue Canada to learn more about the companies or the reported data.

27.57 In all, Environment Canada has completed only 24 ODS inspections in the Ontario and Quebec regions in the past three years, even though these regions include over 80 percent of the thousands of companies that use ODS and that therefore may have imported or exported ODS. In contrast, 90 ODS inspections were completed in the three smaller regions over the same period. In effect, companies subject to ODS inspections have a much greater likelihood of being inspected in some regions than in others.

27.58 Environment Canada's inspection plans should, in a consistent manner across regions, identify companies subject to inspection under the *CEPA* ODS regulations.

27.59 Environment Canada should apply consistently across all regions its criteria for selecting companies to inspect.

27.60 Environment Canada should determine and carry out the level of inspection coverage it considers necessary to ensure compliance with the ODS regulations and verify the accuracy of data reported to the United Nations Environment Program (UNEP).

Department's response: Environment Canada agrees on the need for a nationally consistent inspection plan for companies subject to inspection under the ODS regulations. A National Inspection Plan is prepared annually, which reflects both national and regional priorities. Enforcement and program branches provide input. Information compiled from the program branches is communicated to regional enforcement staff to plan inspections of companies that have requested and received permits. Environment Canada agrees that this information can and will be communicated in a more consistent manner to inspectors.

Environment Canada agrees that criteria for selecting companies to inspect should be applied consistently across regions. These criteria will be based on an assessment of risk (potential of illegal import/export) by industry sector.

Environment Canada has determined that ODS regulations are a departmental priority and inspection coverage will be determined based on an assessment of the potential risk of illegal import and export of ODS. The Department currently has 68 full-time designated inspectors, and is responsible for enforcing more than 30 CEPA regulations.

Given the great potential for illegal import/export of ODS, the majority of Environment Canada's enforcement effort has been focussed on working with our partners — domestic and international— to determine and stop the illegal transboundary movement of ODS. There have been several notable successes in this regard, and more are expected as Environment Canada establishes new partnerships and improves existing ones.

Results from previous inspections show that the data reported to UNEP were accurate.

Going beyond the *Montreal Protocol*: The 1992 National Action Plan

Tasks being accomplished

27.61 1992 National Action Plan. In October 1992, a federal-provincial working group led by Environment Canada prepared a national plan later published by the Canadian Council of Ministers of the Environment (CCME). The 1992 National Action Plan for Recovery, Recycling and Reclamation of CFCs aimed to achieve the implementation of harmonized provincial regulations on recovery and recycling, in order to reduce emissions of CFCs into the atmosphere. The federal government considered a nationally consistent recovery and recycling regime to be critical to achieving its objective of an accelerated phase-out of CFCs. Canada was among the first countries to introduce such a regime and, at the time, it went above and beyond the requirements of the *Montreal Protocol*.

LESSONS LEARNED IN GLOBAL OZONE LAYER PROTECTION

Flexible but incremental

Designers of the *Montreal Protocol* began with the end in mind but implemented the phase-out incrementally, or in phases. Governments did not wait for final solutions to be in place before making commitments — the journey began with a “single step”. By design, the *Montreal Protocol* was flexible, with built-in provisions for adapting to new circumstances through adjustments and amendments.

Pushing the boundaries and harnessing industry

The *Montreal Protocol* successfully harnessed competitive forces and spurred industrial competition, entrepreneurship and innovation. In 1987, 1990, 1992 and 1995, governments set phase-out targets that pushed the limits of technology — and in each case, technology-based barriers tumbled as industry responded with solutions.

Scientific evidence and consensus

When the *Montreal Protocol* was negotiated there were many areas of scientific uncertainty. The establishment of the Scientific Assessment Panel provided an effective forum for obtaining and reporting consensus among international scientists and research institutions and for supporting policy decisions. Concerted and sustained scientific investigation into the causes and effects of ozone layer depletion provided evidence upon which to base control actions. Such evidence was instrumental in uniting governments, industry and environmental groups in a common purpose.

Collaboration and consultation

The *Montreal Protocol* has succeeded because of a deliberate and managed collaboration among industry, environmental activists, academia and governments. Such collaboration was fostered throughout the structure of the *Montreal Protocol* process and committees. The Technology and Economic Assessment Panel (TEAP), dominated by industry members, was especially effective at mobilizing industrial support, promoting technology exchange and identifying the boundaries of technology, thereby supporting policy decisions.

Measurable targets

The *Montreal Protocol* adopted a high level of precision by implementing clear, measurable phase-out targets and schedules, allowing for effective measurement of progress. Mandatory data reporting facilitated tracking of countries' performance against their commitments and country-to-country comparisons.

Information and technology exchange

The adoption and application of alternative technologies was greatly facilitated through managed technology transfer initiatives. Some transfers occurred formally through the Multilateral Fund sponsored programs, including bilateral assistance projects, as well as informally through industry-led workshops and technical assistance, and government-to-government training.

27.62 The 1992 National Action Plan is a federal-provincial partnership, based on shared responsibilities, and was the result of political and jurisdictional compromise. It established a series of tasks directing the federal and provincial governments to take action in specific areas.

27.63 As custodian of the Plan, Environment Canada is responsible for managing the harmonization process. Its tasks include monitoring the implementation of the process, facilitating communication and information sharing among provinces, and identifying and communicating discrepancies in provincial regulations. Successful implementation of the National Action Plan is highly dependent on actions taken by provinces.

27.64 **Many of the tasks specified in the 1992 National Action Plan have been accomplished.** We identified three areas where progress has been particularly significant: development of a Code of Practice, implementation of provincial regulations, and technician training.

27.65 **Code of Practice.** A Code of Practice for the Elimination of Fluorocarbon Emissions from Refrigeration and Air Conditioning Systems was published under section 8 of the *Canadian Environmental Protection Act (CEPA)* in March 1991. The Code has served as a foundation for provincial regulations, has formed a major part of the technician training program (described below) and has been used by federal departments in the preparation of their ODS management strategies. Industry acceptance of the Code has been favourable and supportive. The Code was updated in 1996.

27.66 Harmonization of provincial regulations. As of mid-1997, nine provinces and the Yukon Territory had ODS regulations in force, and the Northwest Territories had guidelines in place. At a high level, there is substantial harmonization of the content of these regulations across the country. In our opinion, Environment Canada is to be credited for its efforts in co-ordinating a complex harmonization process; without such efforts, the level of harmonization may have been lower.

27.67 Technician training program in ODS. In 1992, Environment Canada and the Heating, Refrigeration and Air Conditioning Institute (HRAI) jointly developed a training program for service technicians. Its aim was to promote environmental awareness and sound work practices by technicians installing or servicing refrigeration and air conditioning equipment and systems. To date, 75,000 technicians have been trained. However, a significant gap in coverage exists because the province of Quebec has not yet implemented a training program.

Gaps in harmonization and in the measurement of results, benefits and costs

27.68 Impacts of provincial inconsistency. Based on suggested guidelines, the provincial regulations were enacted in succession, allowing a province to deviate from the guidelines to reflect the experience gained by another jurisdiction and to respond to local circumstances. As a result, there are some differences in detail among the provincial regulation regimes. The current level of harmonization is considered by many government officials to be as good as it gets in Canada. However, some industry members, particularly those who conduct business in more than one province, are of the view that the gaps in harmonization are significant and indicate a failed process that imposes unnecessary costs on business.

27.69 A broad comparison of the regulations was carried out by the federal-provincial working group in 1995. This comparison identified several differences, including deadlines for prohibiting certain uses of ODS, reporting of accidental releases, labelling of serviced equipment, and use of refillable containers. The working group did not assess in detail the significance of these differences or their potential impacts on health, the environment and industry. Environment Canada states that consultations held during that period did not reveal areas of concern that would have warranted further investigative studies.

27.70 Environment Canada, through the federal-provincial working group, should assess the economic and environmental significance of differences in the provincial regulations. Significant differences should be brought to the attention of the Canadian Council of Ministers of the Environment (CCME) for its consideration and possible action.

Department's response: Environment Canada will propose to the Federal-Provincial Working Group (FPWG) that such a study be undertaken. If the FPWG is agreeable to such a study, then the Department as chair of the FPWG will co-ordinate the study and bring the results to the CCME ministers' attention at their fall 1998 meeting.

27.71 Measurement of results of the 1992 National Action Plan is problematic. We found it difficult to understand the commitments made, due to the lack of measurable or quantifiable objectives and targets, the use of imprecise language and undefined terms, and the use of qualifiers. We could not clearly link the stated objectives with the "components deemed essential" to the tasks identified for action.

27.72 Environment Canada believes that its data on production, import and export of ODS, coupled with results from periodic surveys of "use patterns", demonstrate, albeit indirectly, that the National Action Plan was successful in reducing the demand for newly produced CFCs (a stated objective) in the years prior to 1996.

27.73 These and other results, however, have not been directly measured or quantified. The effectiveness of provincial regulations in "minimizing" emissions of CFCs (a stated objective) has not been demonstrated, primarily because an infrastructure for data collection and tracking was never established, even though it was considered an "essential component". An evaluation of the costs to industry and governments was not undertaken prior to the

Plan's approval and implementation, or since. As a consequence, neither the benefits nor the costs of the National Action Plan are known, making its cost effectiveness impossible to determine.

27.74 It is troubling to us that the Plan, which led to provincial regulations from coast to coast, has not been subjected to public scrutiny of its cumulative costs and benefits. We are particularly concerned because the lack of effective measurement of results, benefits and costs can affect the ability to make sound decisions on the future direction of the program and its related activities. Environment Canada has advised us that it is not its normal practice to conduct cost-benefit analyses of "policies" such as the National Action Plan; rather, each province is responsible for its own regulation.

27.75 The 1992 National Action Plan mobilized political will and stimulated action. However, in our view, the weaknesses we have described underscore the complexities involved in managing a federal-provincial partnership. They also raise important questions about the respective accountabilities of the governments involved, particularly of the federal government.

27.76 A federal-provincial partnership was the federal government's chosen strategy for achieving some of its environmental goals. While we believe that there is a limit on the extent to which the federal government can be held accountable for the actions of provinces — or lack thereof — we nevertheless believe the federal government is accountable for the nature and management of the Plan. This is highlighted in paragraph 27.110.

Educating the Public: Is It Working?

27.77 Environment Canada and Health Canada, in partnership with numerous environmental, health, and educational non-government organizations, have used a variety of means to educate Canadians about ozone layer depletion, associated health risks, and potential measures to reduce the risks. Arguably, the most familiar of these are Environment Canada's "UV Index" and "Ozone Watch". Canada was the first country in the world to issue nation-wide daily forecasts in this manner and it has become a model for countries around the world.

27.78 Through these efforts, along with extensive media coverage (see Exhibit 27.5), classroom education, product labels and commercial advertising, Canadians have become highly aware of ozone depletion and the risks it poses to our health and environment. This is confirmed by public opinion surveys. However, awareness of risks is only the first step toward achieving the real objective, which is to change personal behaviour to reduce health risks to acceptable levels. This is recognized as a complex task, particularly among teenagers and young adults.

Exhibit 27.5

(This exhibit is not available, see the Report)

27.79 Disturbingly, a recent national study found that at least half of all Canadians, especially those age groups most vulnerable (teenagers and young adults), do not protect themselves adequately from UV-B radiation during leisure activities. While the true reason for this lack of protective behaviour is unknown, in our opinion the long-term health consequences and costs are potentially very significant and not to be ignored.

27.80 Health promotion and awareness are the responsibility of Health Canada. Exposure to UV-B radiation is one of many health risks to Canadians that the Department addresses. There is no assigned leadership within the Department for specifically communicating UV-B exposure risks, and no formal strategy to promote behavioral change specific to UV-B radiation exposure. Officials advise us that current and projected budget cuts are likely to substantially reduce the remaining capacity in this area, potentially resulting in an increased risk to human health along with the associated costs.

27.81 Health Canada, in co-operation with Environment Canada and other partners, should assess the significance of recent public opinion surveys and the effectiveness of current communication activities in promoting behavioral change and, based on its findings, determine the need for renewed or expanded communication programs, particularly among high-risk groups.

Health Canada's response: In co-operation with Environment Canada and other partners, Health Canada will review existing programs to optimize efforts aimed at educating Canadians on promoting changes to personal behaviour that could reduce risks to health and resultant costs associated with a depleting ozone layer; while efforts will be directed to the whole population, vulnerable sections of the population will be targeted.

Environment Canada's response: Environment Canada will continue to work closely with Health Canada and other partners in both workshops and presentations to educate Canadians about the science of stratospheric ozone depletion, associated health risks, and potential actions Canadians can take to protect themselves.

Federal ODS Stewardship: The Not-So-Greening of Government

27.82 Substantial quantities of ODS are being used and stored within federal facilities across Canada. We had expected the government, as Canada's largest corporate entity, to be as demanding of its own operations as it is of those in the regulated community. Our expectations were heightened by explicit commitments to green government operations, which advocated the role of government as a leader.

27.83 Therefore, we looked at the clarity and consistency of objectives related to the use and phase-out of ozone-depleting substances, to assess the extent to which custodial departments have implemented responsible management practices. Departments selected for this review were National Defence (DND), Public Works and Government Services Canada (PWGSC), Fisheries and Oceans, Transport Canada and Environment Canada.

Government-wide direction and cohesion lacking

27.84 In the 1995 *Guide to Green Government*, and through other means, the government has declared its commitment to green its operations and to emulate best practices, recognizing its unique position to lead by example. However, these commitments have not been supported by government-wide policy or operational direction to departments on the management, replacement or elimination of ODS. Each department is left to interpret the government's leadership intentions and develop operational performance expectations, largely within existing budgets. In our view, this has resulted in a minimalist approach to the management of ODS, uneven implementation in departments and inconsistent treatment of common issues.

27.85 In our opinion, the federal government has failed to provide direction and has missed or ignored available opportunities to do so, including the 1995 *Guide to Green Government* itself. Unlike some foreign governments, the Government of Canada does not routinely include its own operations within the ambit of regulated ODS end-use controls.

27.86 Since the early 1990s, officials in Environment Canada and other departments have made continuous efforts to define and promote ODS management practices within federal departments. However, such efforts were undertaken in the absence of a clear mandate and authority to do so. The voluntary nature of Environment Canada's activities was welcomed by some departments but challenged and rebuked by others. In effect, no department is in charge.

Development of strategies slow but proceeding

27.87 Despite the lack of specific direction, individual departments have demonstrated initiative in the development of strategies for managing their ODS. We observed several examples of strong facility-level actions with progressive practices, often driven from the bottom up by self-motivated individuals. Nonetheless, there are significant variations among these departmental strategies — and in some cases within individual departments — in their degree of maturity, the specific nature of commitments, and the level of implementation.

27.88 Departments that have an inherent operational orientation, such as PWGSC, DND and Transport Canada, have tended to implement procedures and systems quickly. PWGSC, for example, prepared its CFC management strategy in 1992.

27.89 The other departments have been somewhat slower to react. Environment Canada, for example, has yet to finalize its strategy, nearly 10 years after the signing of the *Montreal Protocol*, although it has implemented a pilot program at major facilities. Officials in one department advised us that departmental management never approved a strategy for implementation.

27.90 As part of the audit, we interviewed five private sector organizations in order to draw some comparisons about policy direction and implementation. Based on those organizations' experience, we observed that federal departments have been slower to react to the ODS issue and less aggressive in rationalizing existing equipment and converting to alternatives. We also observed that private sector companies are more inclined to set phase-out and emission-rate targets based on numeric percentages.

Low priority for ODS issues

27.91 Most of the departments indicated that ODS management is a low priority. Departments expect effective ODS strategies and actions to be reflected in their sustainable development strategies (SDS) and environmental management systems. While this may provide more leverage for comprehensive ODS management policies, in some cases attention to the ODS issue is being lost as departments focus on preparation of their SDS.

27.92 Departmental commitments are generally designed to meet the requirements of the *Montreal Protocol* and/or *CEPA* regulations (neither of which controls uses or emissions) and the *CEPA* Code of Practice. The commitment to comply with provincial legislation is uneven. Virtually all the departments we surveyed cited economic, not environmental, considerations as a primary driving force behind their ODS strategies. Departments cited the lack of resources and the desire to exercise fiscal responsibility as significant constraints.

27.93 **Departmental ODS strategies are limited in their reach.** Departmental ODS strategies are generally based on minimizing emissions of ODS from operational equipment while maximizing the equipment's economic life. This reflects the perspective that the solution to ozone layer depletion is the continued, conservative use of existing equipment and materials. Few departments have established target dates for the early phase-out or conversion of existing equipment, or set direction for the selection of acceptable alternatives or destruction of surplus quantities. This is directly related to the lack of direction to do otherwise, uncertainty about the long-term use of existing alternatives such as HCFCs, and a lack of acceptable alternatives in some applications. It is consistent with what we found in some (but not all) private sector organizations, but not what we expected to find within the federal government, given its commitment to lead by example.

Results being achieved but not always measured

27.94 We observed a low rate of conversion of large CFC-based refrigeration and air-conditioning equipment to alternative refrigerants, continuing the risk of slow release of CFCs. In many but not all cases, full life-cycle analysis of conversion or replacement options is not undertaken. Departments report quantities of CFCs in storage to service equipment for decades ahead. One even advised increasing its existing inventory. This will likely prolong the use of ODS and discourage the conversion to alternatives.

27.95 Results in halon fire extinguishing systems were more encouraging. While many halon systems remain in service due to the lack of acceptable replacements, they have largely been reduced to those in critical applications.

27.96 Departments generally remove ODS when equipment is converted or replaced, and the material is either stored for future reuse or returned to the commercial market. In many cases, responsibility for servicing and maintenance of equipment is transferred to third-party contractors, with the expectation that they will follow provincial regulatory requirements. There are very few initiatives to destroy surplus ODS or associated equipment.

27.97 A consolidated inventory of ODS at all federal facilities does not exist. Instead, the regions and facilities within the various departments are responsible for completing ODS inventories. Among and within departments, the existence, accuracy and level of detail of inventories is uneven.

27.98 We were unable to measure or quantify overall results achieved. No department could provide us with an up-to-date summary of the status of its implementation, although this information was often available at a facility level.

Direction for federal facilities is needed

27.99 It is our strong expectation that comprehensive and effective sustainable development strategies and environmental management systems will substantially strengthen the robustness of existing ODS management practices and lead to improvements in results, and in their measurement.

27.100 In 1995, Environment Canada started to develop regulations for federal facilities under *CEPA* in order to ensure that there is no regulatory gap, considering the measures in place for the private sector. The proposed regulations will send important signals to departments, particularly those that have yet to implement ODS management practices.

27.101 We are concerned that Environment Canada may lack the capacity to enforce these proposed regulations effectively.

27.102 The proposed regulations generally reflect the content of existing provincial regulations, and few departments surveyed expect a substantial impact on existing practices. If the regulations are implemented in their current form, and in the absence of any other directive from the federal government, in our opinion substantial gaps in direction will still remain in areas such as phase-out targets for all applications, the management of stockpiles, the conversion to or replacement with environmentally acceptable alternatives, and the destruction of surplus ODS.

27.103 **The federal government should assign the responsibility and authority to Environment Canada, or another department of its choosing, to clearly articulate its expectations with respect to leadership in the management and elimination of ODS in federal operations and, on that basis, provide clear direction to departments. Such direction could be subsequently reflected in departmental sustainable development strategies and environmental management systems.**

Department's response: Environment Canada agrees that a clear assignment of the responsibility and authority to deal with ODS issues would enhance the direction provided to government departments. For its part, Environment Canada is prepared to articulate its expectations of federal operations with respect to the management and elimination of ODS. Our expectations for management of ODS will clearly be spelled out in the halocarbon regulation for federal facilities, currently in draft stage. The revised refrigeration Code of Practice and the Halon Code of Practice recently announced in Part I of the Canada Gazette further articulate our expectations.

Turning to the Future: Finishing the Job of Ozone Layer Protection

27.104 **Loss of momentum.** Government officials from developed countries report a loss of momentum, attention, and resources for their ozone layer protection programs, in part due to a perception that the problem has been resolved. We observed similar conditions and perceptions in Canada.

27.105 **The job is not done.** The ozone layer has not recovered, and will not for at least another 50 years, assuming that controls contained in the *Montreal Protocol* are fully implemented.

As global emphasis in protecting the ozone layer necessarily shifts from developed to developing countries, perhaps the greatest threat to ozone recovery is apathy and loss of commitment in developed countries. Direct action by developed countries in transferring their technical, scientific and regulatory expertise is crucial, though its dividends may not be immediately evident.

— Elizabeth Dowdeswell, Executive Director, UNEP.

27.106 As noted in paragraph 27.29, the challenges facing governments in their quest to solve ozone layer depletion have shifted dramatically since the *Montreal Protocol* was first negotiated. Opportunities do exist for the

federal government to take continuing and additional actions to speed the recovery of the ozone layer and ensure full implementation of the *Montreal Protocol*. Possible domestic actions include improved management of ODS stockpiles, promoting the development of and conversion to alternatives, enacting tighter controls on ODS such as methyl bromide, and destruction. There are also possible opportunities for Canada to strengthen its assistance to developing countries and countries with economies in transition, by expanding bilateral assistance, mobilizing Canada's official development assistance, working co-operatively with non-government organizations, and providing training to foreign government officials. Environment Canada has demonstrated an awareness of many of these.

27.107 Not all of these possible actions have equal effects or costs, and some require globally co-ordinated implementation. In a period when departments' financial and human resources are diminishing, the challenge is to use sound science to identify and implement those actions that, relative to expenditures, will lead to the greatest benefit to ozone recovery and reduction in risk. This entails setting and balancing priorities among potential domestic and international actions. We could not find evidence that the processes used by Environment Canada to identify and set priorities among competing actions make use of structured comparative analyses of their relative costs and benefits.

Revising the National Action Plan

27.108 In May 1995, the Canadian Council of Ministers of the Environment (CCME) approved and released six specific recommendations to strengthen Canada's efforts to protect the ozone layer. Though noble in intent, the recommendations were generally not accompanied by specific actions and tasks, defined accountabilities or measurable targets. Environment Canada has been slow to act on many of these recommendations.

27.109 The federal-provincial working group, led by Environment Canada, is currently revising the 1992 National Action Plan in consultation with affected parties. The draft revised plan identifies a broad range of tasks and control actions, some of which are carried over from the 1992 National Action Plan and the above-noted 1995 recommendations. In effect, Environment Canada, on behalf of the federal government, has signalled its intent to maintain and renew a federal-provincial partnership through revisions to the National Action Plan.

27.110 In order to address weaknesses in the 1992 National Action Plan, Environment Canada should seek to have included in the revised plan, or other accompanying documentation, the following:

- **demonstration of the expected benefits and costs;**
- **clearly articulated roles, tasks and responsibilities of the respective levels of government;**
- **measurable objectives, targets and expected outcomes;**
- **procedures for reliably measuring and reporting on performance; and**
- **mechanisms to provide for redress and necessary program adjustments.**

Department's response: The revised National Action Plan (NAP) has gone through a very thorough public consultation process and responds to the needs identified by stakeholders to strengthen Canada's Ozone Layer Protection Program. Many of the tasks in the new NAP are studies to determine if further control measures are needed. Identifying cost-effective measures will be an important component of these studies. Comprehensive socio-economic cost/benefit analysis will continue to be carried out by the responsible regulatory agency where a regulatory approach is the appropriate response. The plan clearly identifies the tasks, roles and responsibilities, as well as outcomes and timelines.

Although the Federal–Provincial Working Group already submits an annual report on its operations to the National Air Issues Co–ordinating Committee (NAICC), we will strengthen the report to include progress in implementing the NAP. This report will be publicly available on the Green Lane. We will also re–evaluate the NAP every two to three years to identify the need for redress and adjustments. The result of this evaluation will be reported to NAICC.

27.111 Tasks included in the revised draft plan, and the priority assigned to each, were established by the federal–provincial working group on the basis of consultation and professional judgment. We believe that these should be critically re–examined in light of changes in commercial market forces and of the capacity of governments to maintain the necessary infrastructure in the face of budgetary restraint. We further believe that the priority–setting process would be aided by an explicit structured and science–based evaluation of the comparative costs of the tasks and their relative potential effectiveness in reducing risk. That critical process has been hampered by the lack of measurement of the 1992 National Action Plan results and the absence of a comprehensive cost–benefit analysis.

27.112 Among other things, it is important that Canada decide what to do about the conversion of existing equipment and the management or destruction of existing stocks of CFCs and halons.

27.113 Conversion of equipment. Environment Canada has acknowledged that the rate of conversion away from CFC–based equipment in Canada is low, considerably lower than in the United States. To date, Environment Canada has done little to provide users with incentives to convert existing equipment to acceptable alternatives. On the contrary, many equipment owners cite the lack of certainty about phase–out dates for HCFCs and the potential regulation of hydrofluorocarbons (HFCs) as disincentives for conversion.

27.114 We are aware that Environment Canada is presently studying the possibility of establishing phase–out dates for existing uses of CFCs and halons, as some other countries have already done, particularly in Europe.

27.115 Management of halon stocks. In comparison with the management of CFCs through the National Action Plan, the stance of Environment Canada toward the management of halons has been more passive: a halon–based national action plan does not exist. Releases of halons from fire protection systems have always presented, and continue to present, a significant threat to the ozone layer. Environment Canada released a *CEPA* Code of Practice for Halons in 1997 and intends to assess the feasibility of phasing out halons from existing systems. Some stakeholders have expressed concern about the lack of attention given to ensuring proper management of halon stocks.

27.116 Decisions on destruction required. There is vagueness and uncertainty about Environment Canada’s intentions regarding the destruction of ODS, with no discernible policy direction. Despite repeated statements and commitments made on this matter since 1990, little has been done. Resolution of this issue is important for several reasons.

27.117 If the atmospheric release of halons and CFCs contained in existing equipment or stored for future use is prevented, we will reap significant environmental dividends. Scientists predict that such actions could result, respectively, in a 10 percent and 3 percent improvement in ozone layer recovery, but only if undertaken globally.

27.118 Also, as already noted in this chapter, clear direction has not been given to federal departments regarding the ultimate destruction of ODS managed by them.

27.119 Perhaps most important, the potential destruction of ODS has significant implications with respect to the need to maintain provincial regulations on recovery and recycling of CFCs, and for the proposed regulation of federal facilities. If destruction is not supported, the existing regulatory regime will serve to delay, but not prevent, emissions of CFCs into the atmosphere.

27.120 We acknowledge that destruction represents a complex policy issue. We observed that some countries have implemented ODS destruction programs; others are providing substantial funding for the development and demonstration of destruction technology; and others still struggle with the concept. Governments face challenging public policy issues of determining the costs and benefits, deciding who should pay, ensuring technical capacity, and managing the risk of indirectly encouraging intentional release into the atmosphere.

27.121 Environment Canada should clearly articulate the federal government’s position on the destruction of ozone–depleting substances and related equipment and products, including those held by federal departments. If destruction is supported, Environment Canada should commence development of the infrastructure required for implementation.

Department’s response: Environment Canada agrees that a Canadian position needs to be developed on destruction of ODS, including conversion of ODS to non–toxic substances. The role of destruction in managing the surplus stocks is not just an issue for the federal government but also a national and international issue.

One of the tasks identified in the NAP is to develop a national strategy for the management, including destruction, of surplus ODS. Other tasks to be carried out will define the costs and benefits of Canada–wide use phase–outs for CFCs and halons and their impact on surplus stocks. The results of these studies, along with stakeholder consultations, will help determine the role of Environment Canada, provincial authorities and the different stakeholders in the management of surplus ODS in Canada and their ultimate disposal.

Discussions on the need for destruction of surplus ODS, as opposed to their redeployment, have started to take place under the Montreal Protocol. In this context, the federal government will need to articulate its position.

Assessing the needs of developing countries

27.122 The complete, timely and full implementation of the *Montreal Protocol* by developing countries is in jeopardy. Senior officials from governments of several developed countries and from the “Implementing Agencies” under the Multilateral Fund (see Appendix B) expressed concern to us about whether the Multilateral Fund by itself would be sufficient to ensure the timely achievement of the *Montreal Protocol* objectives in developing countries.

27.123 Production of ODS in developing countries is growing, and a majority of them have indicated that they will have difficulty meeting their freeze obligations in 1999. In addition, a few countries with economies in transition are in default of their international obligations.

27.124 While financial assistance to developing countries is critical, they also require technical and regulatory capacity in order to manage ozone layer protection on a long–term basis. Implementing Agencies in particular support the critical need for transfer of developed country expertise in areas of science, technology and regulatory design and implementation.

Needs assessment lacking

27.125 In light of this, we had expected to find an identification and evaluation of additional opportunities for strengthening assistance to developing countries, including potential actions both within and outside of the Multilateral Fund. It is a matter of protecting our health and our past investment. However, we could find no evidence that Environment Canada or the Canadian International Development Agency (CIDA) had formally and explicitly analyzed the needs of developing countries in this regard, independent of reviews undertaken internationally. There was little evidence that either organization has even considered the need to conduct such an assessment.

27.126 This was in sharp contrast to the awareness and actions we noted in other developed countries. Many have reacted to recent trends by implementing assistance initiatives that go “above and beyond” actions called for in the *Montreal Protocol*, including the mobilization of traditional official development assistance.

Establishing the balance between domestic and international actions

27.127 Program responsibilities within Environment Canada separate work related to international negotiations and assistance from domestic controls, reflecting for the most part historic organizational design and past priorities. The funds available for international and domestic use do not originate from the same source. Consultation and co-ordination do occur between these spheres of activity within the Department. However, we noted a lack of structured comparison of the relative effectiveness of potential domestic and international actions to balance effort between them. As a result, we are concerned that the total pool of available resources may not be optimized to provide maximum benefit to the protection of the ozone layer.

27.128 **As Environment Canada develops its future plans related to the elimination of ODS and reduction of risk, it should ensure that available resources are directed to those activities that maximize benefits to ozone layer recovery. This necessarily involves consultation with affected stakeholders and exercising professional judgment but should also be supported by the application of science-based priority-setting tools and processes that provide for the comparison of the relative benefits and costs of available risk reduction opportunities.**

Department’s response: Environment Canada acknowledges the need to be active both domestically and internationally. We have international financial obligations to the Multilateral Fund over which we have limited flexibility. In addition, there are also financial obligations related to our domestic programs: regulations implementation and enforcement, federal-provincial co-ordination, stakeholder information and consultation, etc. At the same time, we wish to ensure that Canada continues to be exemplary in reducing the environmental threat from ODS, working within our existing government structures. Environment Canada will undertake a more structured assessment of the relative effectiveness of its activities to determine where resources might be best deployed given existing constraints.

Conclusion

27.129 Global efforts to understand and protect the ozone layer have been under way for several decades. Through the *Montreal Protocol*, much has been accomplished and learned, although much remains to be done before success can be declared.

27.130 We believe these efforts are a demonstration of sustainable development in action, in both developed and developing countries. They are evidence that the environment and the economy can go hand in hand as the world attempts to solve a serious environmental threat.

27.131 Canada, through the leadership of Environment Canada and in collaboration with other federal government departments, provincial governments, industry and other stakeholders, has met and in some cases exceeded its obligations under the *Montreal Protocol*. Canadian achievements compare favourably with those of other countries, in both influencing and implementing the international agenda. Canada has also made substantial progress on its domestic policy commitments.

27.132 A regulatory infrastructure under *CEPA* exists to achieve future *Montreal Protocol* requirements, although weaknesses in the enforcement regime have been noted.

27.133 Canada has also implemented regulatory and non-regulatory controls not required by the *Montreal Protocol*. Many of the commitments in the 1992 CCME National Action Plan have been met. Implementation of commitments made by the CCME in 1995 to strengthen Canada's program has been slow; several key issues, including additional measures to promote conversion of existing equipment and destroy surplus ODS, require a clear articulation of federal policy. We are concerned about the future ability to measure progress achieved in the revised National Action Plan, due to the lack of clear measurable objectives and a suitable measurement infrastructure.

27.134 Federal commitments to green government operations and to lead by example have not been supported by government-wide policy or operational direction on the management of ODS. We observed wide variations in the consistency of departmental ODS policies and strategies, as well as gaps in direction on the phase-out of uses, selection of acceptable alternatives and the destruction of ODS in federal operations.

27.135 Implementation of ODS management practices by federal departments has been mixed. While we observed some progressive facility-level practices, most departmental practices reflect the continued use and emission of CFCs and halons in order to maximize the economic life of equipment. The tracking of results achieved toward meeting established objectives is weak and is generally undertaken at the facility, not departmental, level.

27.136 Canada's implementation of the *Montreal Protocol* through *CEPA* has generally been developed on the basis of scientific consensus, stakeholder consultation and detailed socio-economic analysis. The information base has been developed at an international level and supplemented by domestic analyses.

27.137 We believe that the effectiveness of future federal efforts could be strengthened through the application of science-based priority-setting tools and processes and a balance between potential domestic and international actions.

About the Audit

Objectives

There were four audit objectives:

- **The Control of Ozone–Depleting Substances:** To provide an assessment of progress to date in meeting international and domestic commitments and to assess whether strategies and practices are in place to meet commitments and measure progress in the future.
- **Greening of Government:** To determine the clarity and consistency of objectives regarding the use and phase–out of ozone–depleting substances within government operations and to assess the extent to which selected custodial departments have implemented strategies and actions and achieved results pursuant to established objectives.
- **Ozone Policy Development and Implementation:** To determine whether Canadian public policy on ozone layer protection has been developed and implemented on the basis of sound information.
- **Lessons Learned:** To identify “lessons learned” in the ozone layer protection experience.

Criteria

We expected that Environment Canada should have met all commitments related to the control of ozone–depleting substances (ODS) and established effective systems to measure and report on those programs. We expected that custodial departments should have designed and implemented management systems to control their own use of ODS, in accordance with government and departmental policy and contemporary management practices. We expected that policy should have been developed using sound scientific, socio–economic, technical and environmental information and analytical tools, in order to ensure that control actions will achieve maximum benefit for minimum cost.

Scope

The audit examined the international obligations contained in the *Montreal Protocol* and related decisions of the parties to the Protocol. It also included domestically established control programs and enforcement under *CEPA*. The audit also focussed on government–wide and departmental policy framework for ODS control as well as existence and implementation of strategies to enact policy. The use and integration of analytical tools and information in policy development and implementation as well as performance measurement practices were also considered.

The audit also examined the proposed “Federal Facilities Regulations”, the Environment Canada initiative to improve the ozone layer protection program and the National Action Plan. Finally, our work included the identification of factors that have contributed to the success or failure of Canada’s program and identified approaches used by other agencies or national governments in dealing with similar issues. The timeframe of the audit extended back to the early 1980s in order to obtain the proper historical perspective, but concentrated on regulatory activities since 1990.

Approach

The audit approach consisted of interviews and document review, including existing regulations and supporting documentation, compliance data, existing memoranda of understanding between Environment Canada and other federal departments, and any existing administrative or equivalency agreements with the provinces and/or territories. The audit was conducted primarily within Environment Canada but also included Foreign Affairs and International Trade Canada, Health Canada, Revenue Canada, Royal Canadian Mounted Police, Transport Canada, Fisheries and Oceans, Department of National Defence, Canadian International Development Agency, Public Works and Government Services Canada, Correctional Service Canada, the Treasury Board Secretariat and Agriculture and Agri-Food Canada. The audit also included interviews with selected provinces, industry and industry associations, other national governments, UN agencies, environmental interest groups and other stakeholders in order to compare Canadian practices.

Audit Team

John Affleck
Frank Barrett
Jacques Grou
John Reed
Stephanie Taylor

For information, please contact Wayne Cluskey, the responsible auditor.

APPENDICES

Appendix A — The *Montreal Protocol* at a Glance

Key Features of the *Montreal Protocol*

- * **Control measures for ozone-depleting substances (ODS):** “Parties” are required to eliminate the production and “consumption” of “controlled substances” according to binding targets and schedules. Controlled substances include chlorofluorocarbons (CFCs), halons, carbon tetrachloride, methyl chloroform, hydrochlorofluorocarbons (HCFCs), and methyl bromide. (Note: Under the *Montreal Protocol*, “consumption” does not mean “use”; rather, it is a formula for the net supply of ODS into a country). Different phase-out schedules exist for each class of ozone-depleting substances and for developed versus developing countries. Currently applicable phase-out dates are illustrated below.

Substance	Developed Countries	Developing Countries
CFC	January 1, 1996	January 1, 2010
Halons	January 1, 1994	January 1, 2010
Carbon Tetrachloride	January 1, 1996	January 1, 2010
Methyl Chloroform	January 1, 1996	January 1, 2015
Hydrochlorofluorocarbons	January 1, 2030	January 1, 2040
Methyl Bromide	January 1, 2005 ¹	January 1, 2015 ¹

¹ These phase-out dates were agreed to by the Parties at 9th Meeting of the Parties, September 1997. These dates are generally subject to exemptions for approved “essential uses”.

Source: United Nations Environment Program

- * **Trade measures:** “Parties” are required to ban imports and exports to “non-parties” to the *Montreal Protocol* of controlled substances and products containing controlled substances.
- * **Special provisions for developing countries:** The *Protocol* includes mutual but differentiated obligations for developed countries and developing countries. Developing countries are given a grace period (10 years or more) to comply with the control measures and are provided with financial assistance to accomplish phase-out through the Multilateral Fund for the Implementation of the *Montreal Protocol* (The Multilateral Fund).
- * **Data reporting:** Parties are required to submit data to the UNEP on their production, imports, exports, destruction and recycling of controlled substances yearly.
- * **Exchange of information:** Parties are required to share information on best technologies, alternatives to controlled substances, and public education, and to report on their activities every two years.
- * **Non-compliance procedures:** Procedures are established to encourage compliance by parties who fail to meet their obligations under the *Protocol*. These procedures are presently under review.

- * **Assessment panels:** The *Protocol* has established expert “assessment panels” on Atmospheric Science, Environmental Effects, and Technology and Economics in order to provide state-of-the-art information and advice.

- * **Revisions:** The *Protocol* has built-in provisions for making changes to the control regime. Since 1987, the *Protocol* has been amended twice, in 1990 adding carbon tetrachloride and methyl chloroform and in 1992 adding hydrochlorofluorocarbons (HCFCs) and methyl bromide.

Appendix B — The Multilateral Fund at a Glance

Key Features of the Multilateral Fund

- * The Parties to the *Montreal Protocol* established the “Multilateral Fund for the Implementation of the *Montreal Protocol*” on an interim basis in 1990. Its purpose was to provide financial assistance to qualified developing countries who are parties to the *Montreal Protocol* to assist them in implementing their control obligations. The Fund was established in its final form on 1 January, 1993.

- * The Fund is governed by an **Executive Committee**, made up of seven developing and seven developed countries. To obtain assistance from the Multilateral Fund, a developing country will normally work with one of the designated **Implementing Agencies** — The United Nations Development Program (UNDP), the United Nations Environment Program (UNEP), the United Nations Industrial Development Organization (UNIDO) or the World Bank — to assess its industrial situation and identify specific projects for approval. A full-time **Secretariat** located in Montreal provides support to the Executive Committee and reviews project proposals and work plans submitted by the Implementing Agencies. Payments from the Multilateral Fund are subject to strict eligibility criteria and require approval of the Executive Committee.

- * The amount of replenishment of the Fund is negotiated by the Parties on a triennial basis, based on expert advice received from the Secretariat, the Implementing Agencies, and the Technology and Economic Assessment Panel. For 1991-1993, the Fund was US \$240 million upon the signing of the *Montreal Protocol* by India and China. A budget of US \$510 million (including a carry-over of US \$55 million from the 1990-1993 period) was adopted to cover the 1994-1996 period. For the period 1997-1999, the level of funding has been set at US \$540 million (which includes a carry-over of US \$74 million from 1994-96). Contributions from individual donor countries are set according to percentages contained in the United Nations scale of assessments.

- * By design, the Multilateral Fund is intended to meet the agreed “incremental costs” of ODS phase-out, that is, in principle the increased costs to developing countries of using ozone-friendly technologies.

- * Provisions of the Fund allow a donor country to make up to 20 percent of its assessed contribution in the form of “bilateral assistance”. This allows a donor country to form a partnership with an eligible recipient country and implement projects that, subject to eligibility criteria and approval of the Executive Committee, match a donor country’s capability with the needs of a recipient country.

- * As of June 1997 over 1,800 projects had been approved by the Executive Committee, including 800 investment projects, for a total of US \$618 million. This level of funding is expected to result in the permanent, annual phase-out of 81,000 ODP tonnes. These projects cover all industrial sectors and the Multilateral Fund has effectively created global business opportunities for consultants and technology providers. The majority of investment projects are tendered on a competitive basis through the UN system.

Chapter 28

Fisheries and Oceans Canada

Pacific Salmon: Sustainability of the Resource Base

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Fisheries and Oceans Canada

Pacific Salmon: Sustainability of the Resource Base

Assistant Auditor General: Don Young
Responsible Auditor: John McCullough

Main Points

28.1 Canada's ability to sustain the Pacific salmon resource at the present level and diversity is questionable given the various factors influencing salmon survival, many of which are beyond its control. While Fisheries and Oceans has built up major salmon stocks, others are declining and many are considered threatened. There is evidence that habitat loss is contributing to these declines. However, no overall status report on salmon habitat is available to assess the impact of habitat loss on the resource.

28.2 Fisheries and Oceans has a strong mandate in the *Fisheries Act* to protect salmon and their habitat. However, due to the division of environmental powers under the *Constitution Act*, the support and co-operation of the Province of British Columbia (B.C.) and municipalities are prerequisites for sustainability of the resource.

28.3 The Department's Habitat Policy (1986) promotes both sustainability and genetic diversity. The Policy balances proactive elements (land use planning, integrated resource management and development of guidelines) and reactive elements (project review/approval, compliance monitoring and enforcement). The Department has tended to focus more on the reactive elements, but without sufficient emphasis on monitoring and follow-up.

28.4 Habitat management requires improved co-ordination within the Department and the increased involvement of external groups, including provincial and municipal governments, stakeholders and the public, under agreements that include accountability provisions, where appropriate. The Department's overall responsibility for habitat requires clear accountability to maintain control of the process and depends especially on B.C. being held accountable for its own habitat responsibilities.

28.5 The opportunity now exists for Fisheries and Oceans to further develop and strengthen its relationship with the Province following the signing in April 1997 of the new Canada-B.C. Agreement on the Management of Pacific Salmon Fishery Issues. The Agreement is intended to revisit existing areas of intergovernmental co-ordination covered under the 1985 General Fisheries Agreement and to examine other areas for co-operation. B.C. has released a discussion paper in anticipation of future negotiations. The Department's position on habitat management is expected to be clarified to prepare it for these negotiations.

Introduction

Importance of salmon habitat

28.6 For thousands of years, Pacific salmon have been a vital part of life on the West coast of Canada, and the six species of salmon in British Columbia — sockeye, pink, chum, chinook, coho and steelhead — continue to generate a wide range of economic, social and cultural benefits.

28.7 Salmon fisheries contribute significantly to local, provincial and national economies. Based on information obtained from Fisheries and Oceans, the commercial fishery, which takes all species, had an average landed value of \$265 million per year over the period 1986 to 1995. Results of the latest recreational fishing survey indicate that direct expenditures alone by anglers in B.C. tidal waters exceeded \$228 million in 1990, with the overall economic impact being considerably larger. This fishery is focussed essentially on three salmon species — chinook, coho and steelhead.

28.8 Salmon are a primary food source for the Aboriginal people and fisheries are a mainstay of their economy. Protecting these fisheries and the resource base on which they depend is therefore an important step in preserving this unique part of Canada's heritage.

28.9 The commercial fishery takes over 90 percent of the annual catch, with the recreational and Aboriginal fisheries sharing the remainder. The latter fisheries are legally protected and are thus a first management priority after conservation needs have been met.

28.10 Although trends in salmon numbers are influenced by catch, as well as marine and freshwater productivity, a healthy habitat is a fundamental requirement for sustaining salmon stocks. Furthermore, the habitat provides food and shelter for other desirable resident and migratory aquatic and terrestrial wildlife, while providing water for human consumption and other uses. The challenge for Canada is how to protect salmon habitat in the context of sustainable development, which seeks to balance economic development with environmental protection.

Responding to change

28.11 Since the introduction of the Green Plan (1990), the federal government has been adjusting its programs to reflect its international commitments to sustainable development and biodiversity. By December 1997, all federal departments must table sustainable development strategies and action plans in Parliament. Recently, Fisheries and Oceans has been the subject of a number of reviews (both internal and external) that have resulted in recommendations for changes in the way it manages salmon habitat.

28.12 This push for change, to which the Department is responding, has also been prompted by internal budget cuts, the Department's amalgamation with the Canadian Coast Guard and the new *Oceans Act*.

Focus of the audit

28.13 In view of the complexity of issues associated with the conservation and protection of the salmon resource and its habitat and the management of fisheries, our audit of the Pacific salmon fishery has been divided into two phases. This report addresses the sustainability of the salmon resource base, with an emphasis on the conservation and protection of habitat; the second phase will address the sustainability of the salmon fisheries, including fisheries management and the allocation of catch, and will be reported in the spring of 1999. In both cases, our examination is confined to the five species of salmon that are managed by Fisheries and Oceans — namely, sockeye, pink, chum, chinook and coho; the sixth, steelhead, is under provincial control. Further details on the audit objective and criteria are found at the end of the chapter in the section **About the Audit**. A glossary of technical terms as used in the text is in Exhibit 28.1.

Exhibit 28.1

Explanation of Key Terms As Used in the Text

Stocks	Individual populations of a species that spawn independently in distinct areas; for example, Fraser River sockeye spawning in the Adams and Chilko Rivers are separate stocks of sockeye salmon.
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Sustainable Development	Development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
Genetic Diversity	The “pool” of inherited physical and biological characteristics contained within individual stocks that collectively form a species.
Habitat Policy Objective of “Net Gain”	The Habitat Policy’s guiding principle is to achieve a net gain in the natural productive capacity of fish habitat. As a first step in achieving this overall goal, the Habitat Policy provides that there be no net loss in productive capacity. Although the Habitat Policy acknowledges that there will be some loss of habitat at times, it seeks to achieve an overall net gain by striving to conserve existing habitat, restoring damaged habitat, and, where possible, developing new habitat

Observations and Recommendations

Legislation and Policy

The Department has a strong mandate to protect salmon and habitat

28.14 Under the *Constitution Act* (1982), the federal government has legislative responsibility for Canada’s fisheries. The Minister of Fisheries and Oceans has been assigned responsibility for sea coast and inland fisheries, marine science and administration of the *Fisheries Act*. A key component of this responsibility is the protection of fish and fish habitat from disruptive and destructive activities as described in section 35. Projects with potential impacts on fish habitat are reviewed to determine if they can proceed and, if so, under what terms and conditions. In making these determinations, the Department is guided by its Policy for the Management of Fish Habitat (1986) (the Habitat Policy) and the Habitat Conservation and Protection Guidelines (1994) derived from it. Details on the specific habitat protection provisions in the Act are given in Exhibit 28.2.

Exhibit 28.2

The Legislative Mandate

The *Fisheries Act* was amended in 1977 to include the habitat protection provisions that give the Minister of Fisheries and Oceans the following powers:

- Sections 20, 21 and 22:** The authority to require the construction, maintenance and operation of fish passage facilities at obstruction in rivers; to require financial support for fish hatchery establishments constructed and operated to maintain runs of migratory fish; to remove unused obstructions to fish passage; and to require a sufficient flow of water at all times below an obstruction for the safety of fish and the flooding of spawning grounds.
- Section 30:** The authority to require the installation and maintenance of screens or guards to prevent the passage of fish into water intakes, ditches, canals and channels.
- Section 32:** The authority to prohibit the destruction of fish by any means other than fishing.
- Section 35(2):** The authority to authorize the harmful alteration, disruption or destruction of fish habitat and the conditions under which this may occur.
- Section 37:** Comprehensive powers to protect fish and fish habitat from the discharge of deleterious substances; to request plans for developments that may affect fish; to develop regulations and to modify, restrict or prohibit certain works or undertakings.

Section 37(2): The authority to modify, restrict or prohibit any work or undertaking that is likely to result in the harmful alteration, disruption or destruction of fish habitat, a term that is defined in subsection 34(1) of the Act.

Other Sections: Definitions, penalties and additional powers are provided in sections 34(1), 35, 36, 40, and 43, among others.

Fishery regulations specific to provinces and territories are made pursuant to the *Fisheries Act*, and some of these contain habitat protection sections.

The definition of fish habitat is: **“spawning grounds and nursery, rearing, food supply and migration areas on which fish depend directly or indirectly in order to carry out their life processes.”**

The *Fisheries Act* provides for regulations respecting the conservation and protection of fish. In this respect, it covers all stocks and therefore supports genetic diversity.

28.15 The Habitat Policy’s objective is “net gain” — that is, increasing the amount of habitat available to salmon by conserving existing habitat, restoring damaged habitat and, where possible, developing new habitat. In determining the level of protection afforded to habitat at a given site, the Policy indicates that its potential contribution to those stocks on which communities rely is especially important. The Department is therefore guided by its first operating principle: conservation of the fisheries resource is paramount.

The provincial government’s support is essential

28.16 Canada has made special arrangements with British Columbia concerning day-to-day management of the freshwater fisheries of the province and that of the migratory steelhead. While the *Fisheries Act* applies across Canada, provincial legislation controls land and water use, which also affects fish habitat in freshwater. The B.C. Ministry of Environment, Lands and Parks has conservation officers stationed throughout the province and they assist Fisheries and Oceans in enforcing the *Fisheries Act*, as well as provincial legislation. The continuing co-operation of the two levels of government is therefore essential if freshwater salmon habitat is to be protected.

Conflicting Evidence on Status of Resource Base

28.17 The total numbers of all species of salmon returning to B.C. waters show a positive trend from the early 1970s through 1993, reaching a peak of over 70 million fish in 1989. The annual returns are dominated by production originating from the Fraser and the Skeena Rivers, the two largest river systems on the coast of B.C. The large numbers of sockeye, pink and chum produced in these two rivers are the result, in part, of the enhancement of major stocks.

28.18 While there appears to be little reason for concern about the overall numbers of these three species, the numbers of chinook and coho salmon returning to B.C. waters to spawn tend to be low at present.

28.19 Those stocks that spawn within tributaries of the Strait of Georgia may be declining, with serious problems emerging for some chinook and coho stocks. Chums are considered to be in a sustainable state.

28.20 When the status of individual stocks of salmon that arrive on their spawning grounds is examined in detail, there is evidence that many stocks are under stress. A recent report based primarily on departmental data concluded that, of the 4,906 stocks of salmon in B.C. and the Yukon, on which there was sufficient information to assess their status, 600 are at high risk, 63 at moderate risk and 57 of special concern.

Limited information precludes a complete assessment

28.21 The total number of salmon stocks identified in the above-noted study were 8,171. For 3,265 (40 percent), there were insufficient data on which to determine their status. Due to their small size, these stocks are not of great commercial importance now, but may be important for local sport and Aboriginal fisheries in the future. They are also needed to maintain genetic diversity. At the present level of stock assessment, it may be some time before the status of these stocks is determined — perhaps too late to take remedial action.

28.22 The Department's Pacific Stock Assessment Review Committee (PSARC) process is one where scientific advice on stock status, available catch, methodologies and other technical matters are rigorously reviewed, often involving external reviewers. The PSARC subcommittee dealing with data and data quality has proposed that expenditures be made to improve the nature and quality of the databases. It is hoped that the Canada-B.C. Agreement on the Management of Pacific Salmon Fishery Issues (1997), which provides for provincial representation on PSARC, will be able to address the problem of data quality successfully.

The physical habitat base is being eroded

28.23 While the overall number of salmon returning to B.C. waters is increasing and some major stocks are rebuilding to higher and sometimes record numbers, the numbers and strengths of some individual stocks are declining and are cause for concern. The causes for these declines are complex and include natural processes, such as cyclic changes in ocean productivity and marine survival, alterations of freshwater productivity, both natural and man-made, and human influences, such as fishing and habitat alteration. Habitat loss is a major problem and, in fact, the Department estimates that loss of habitat probably accounts for 20 to 30 percent of the disappearance of small stocks of salmon in B.C. For example, the development of the City of Vancouver has resulted in 70 percent of the Fraser River estuary's original wetland system being altered, mostly by diking and drainage projects, and approximately 50 percent of the estuary's delta habitat being lost to development since 1880. Such changes have resulted in the documented destruction of streams and the subsequent loss of salmon.

28.24 In seeking to achieve a "net gain" of habitat, Fisheries and Oceans first seeks to conserve existing habitat (see Exhibit 28.3) and obtain compensation for damaged habitat under the guiding principle of "no net loss". However, departmental reports on projects indicate that on balance habitat is being lost.

Exhibit 28.3

(This exhibit is not available, see the Report)

28.25 Since the introduction of the Habitat Policy in 1986, Fisheries and Oceans has not prepared an overview report on the status of fish habitat conservation in Canada. While it does report annually to Parliament on the administration and enforcement of the fish habitat protection and pollution prevention provisions of the *Fisheries Act*, pursuant to section 42.1 of the Act, there is no mandated responsibility to report on the Department's performance in meeting the objectives and goals of the Habitat Policy.

28.26 The overall objective of the Habitat Policy is to achieve a "net gain" in the productive capacity of fish habitat. Because productive capacity is difficult to measure in practice, the Department relies on surrogate measures of physical parameters (for example, loss or reduction of a salt marsh or gravel bed) or biological parameters (for example, loss or reduction of food supply) to assess gains and losses of fish habitat. In 1991, in reporting on the Department's implementation of the Habitat Policy, this Office noted that the Department had not yet developed an acceptable, standardized measure of habitat productivity. However, it has since increased its scientific effort in this area.

28.27 The Habitat Policy's first goal is conservation, followed by restoration and development. Given this and the difficulties of measuring habitat productivity, a focus on the protection of existing habitat is warranted. The

Department's Internal Audit of 1993-94 confirmed that this approach was being taken, in that nationally the Department spent only 20 percent of its budget on "net gain" with the remaining 80 percent being directed toward the achievement of "no net loss".

28.28 However, the Department has indicated that current expenditures in the Pacific Region show an almost equal allocation of funds to these two areas. It is unclear whether this is a change in priorities or a reflection of the perceived importance of habitat restoration in B.C. Regular reporting to Parliament on the status of habitat would provide the opportunity for both a review of policy implementation in this regard and new direction to the Department should it be deemed advisable.

Threats to habitat are widespread and increasing

28.29 There are many reasons for loss of habitat given in the scientific literature. Fisheries scientists cite, for example, the direct and indirect effects of forestry operations; impoundments for hydroelectric development and domestic water supplies; mining, agriculture, road and rail construction; and sewage, industrial effluents and urbanization. These activities all have impacts on the life cycle of salmon, although the significance of these impacts on habitat varies over time (see Exhibit 28.4). For example, while forestry practices have improved and their damage to habitat has been reduced in B.C., the impact of urbanization continues to grow and urban streams are now considered to be seriously endangered.

Exhibit 28.4

(This exhibit is not available, see the Report)

28.30 Recent federal statistics show that population growth rates have exceeded 20 percent in the Greater Vancouver area and on the southeast coast of Vancouver Island since 1986. The Lower Mainland population is expected to grow from 1.7 million to at least 3 million by the year 2021. As these areas are significant for salmon production, especially coho, pressure on stocks from urbanization and related infrastructure development is expected to increase. The protection of fish habitat in urban areas may be the Department's most serious challenge in its efforts to maintain the genetic diversity of salmon and particularly coho.

Information management needs improvement

28.31 The senior governments (federal and provincial) are responsible for fisheries resource and habitat inventories in B.C., and progress has been made in this area by the collaboration of the Department and the Province in the Fish Habitat Inventory and Information Program over the last 10 years. Furthermore, there are many promising mapping tools emerging that will integrate renewable and non-renewable resources, and thereby generate more useful land use inventories for the protection of fish habitat. However, these tools are not yet readily available for habitat biologists or technicians, who rely primarily on the Stream Information Summary System, on published maps and reports relating to the area in question, and on their personal files.

28.32 New information is continually being collected by Fisheries and Oceans from on-site inspections at the time of project review. Such information is only now being incorporated into a habitat database, the Habitat Referral Tracking System (HRTS). This system is in place nationally and is intended to be comprehensive in its coverage of proposed and approved projects when fully operational. Although HRTS in the Pacific Region is essentially a recording system for projects covered under the *Canadian Environmental Assessment Act*, it could become a key source of data for both planning and reporting purposes in the future.

28.33 The new data management initiatives are bringing all aspects of land use together to facilitate integrated resource management on a regional or watershed basis. But these various systems are not yet co-ordinated. It is difficult to find mapping techniques that can accommodate planners at both the regional (overview) and community

(individual stream) levels, although progress is being made to rectify this. Current mapping projects often miss small coho streams in urban areas, which is a concern for both Fisheries and Oceans field biologists and community members involved in habitat work, especially where no detailed stream maps are available. The situation is further complicated by the current use of a variety of systems, some political (for example, county, municipality) and some geographic, which often do not coincide with aquatic ecosystems such as river basins.

Information is not always accessible to managers

28.34 Although information is available in various formats, there is a problem of accessibility for both departmental personnel and external interest groups. It is time-consuming and difficult to locate information that may be in electronic format, on maps, in various publications and in files. The Department, in co-operation with the Province, is making an effort to co-ordinate information access, but the activity does not have a high priority. The Department's recent transfer of information to the Internet may be a step in the right direction.

28.35 Information comes in many forms and with differing degrees of reliability. The reliability will determine its standing in the scientific community. Although scientifically acceptable data are essential for determining the status of salmon stocks, an indication of the presence or absence of salmon in a stream may be useful for habitat planning purposes in the absence of more accurate data. While it would be best to collect such information according to an accepted set of standards, in times when resources are limited every piece of information is helpful.

28.36 **The Department should give the collection and management of information on Pacific salmon stocks and habitat a high priority to meet both the needs of resource managers in the field and any reporting requirements on the status of the resource.**

Department's response: The collection and management of information on Pacific salmon stocks and habitat will continue to be given high priority by the Department.

Achieving Sustainability and Protecting Genetic Diversity

Salmon sustainability and genetic diversity depend on habitat conservation and protection

28.37 In order to ensure sustainability, salmon must have access to sufficient and suitable freshwater, estuarine and marine habitat. Freshwater habitat is needed for spawning, the hatching of eggs and the development of fry, the feeding and growth of young salmon and the migration of juveniles to and adults from the ocean. Unfortunately, habitat used by salmon is under stress and in many instances may have already been irreversibly altered from its former natural state.

28.38 The situation is becoming more serious as new threats to salmon abundance emerge. For example, there is growing evidence that abrupt shifts in the productivity of salmon stocks appear to be linked to sudden changes in the marine climate, possibly influenced by global climate change. Changes in climate are expected to cause local effects such as elevated water temperatures and variations in the timing and volume of the seasonal flow patterns of rivers. These changes in habitat conditions could have a significant impact on specific salmon stocks in the Fraser River watershed, resulting in their reduction or eventual loss.

28.39 Protecting the full complement of stocks will help to minimize the impact of such changes, as there is no way of determining ahead of time which stocks will prove to be more adaptable to habitat changes. It also offers general protection to the salmon resource in that the more stocks there are producing juvenile salmon, the greater will be the total numbers entering the ocean. The large numbers, which will be widely dispersed along the coast, may reduce the impact of predation from such species as mackerel and hake.

The Department's Habitat Policy allows for sustainable development and protects genetic diversity

28.40 The objective of the Habitat Policy is to achieve a “net gain” of habitat, thereby ensuring adequate habitat to sustain current stocks of fish. The Policy promotes the integration of habitat needs with fish management objectives through the development of fish habitat/stock production plans for specified geographic areas such as watersheds or components of watersheds. This approach facilitates the incorporation of fish habitat priorities into the broader picture of integrated resource planning, usually initiated at a regional level. The emphasis is on the relationship between salmon stocks and their habitat, and the promotion of planning for their continued productivity within the framework of integrated resource use. The Policy recognizes that habitat conservation will be applied, if necessary, on a stock-specific basis, especially where stocks support community fisheries. This practice supports genetic diversity.

Sustainability must be implemented at the stock level to optimize genetic diversity

28.41 Sustainability of the salmon resource can be achieved in two ways: by concentrating on the protection of, and production from, only the dominant stocks regardless of species, leaving the weaker stocks to survive as best they can; or by focussing on the survival of and production from all stocks, both the strong and weak of all species. By concentrating on the survival of individual stocks, genetic diversity is achieved at the species level.

28.42 While in the past Fisheries and Oceans has managed salmon using both approaches, it has tended to concentrate its efforts on the major stocks. Consequently, there is a lack of assessment data on many of the smaller stocks currently of minor or no economic importance. However, given the complexity and number of emerging environmental and biological problems that are impacting on the salmon resource, a more prudent approach to habitat management is warranted. The greater the number of stocks protected, the stronger the genetic diversity within species, which, in turn, provides insurance against future major catastrophes such as global climate change.

28.43 Fisheries and Oceans should clarify the extent to which it intends to apply sustainability and genetic diversity practices to the management of individual salmon stocks and their habitats.

Department's response: Fisheries and Oceans agrees to provide clarification on how we intend to apply the concept of sustainability and genetic diversity. The Department will continue to apply the Policy for the Management of Fish Habitat to the habitat of B.C. salmon stocks.

28.44 Fisheries and Oceans should develop more explicit operational objectives and targets to address sustainability and genetic diversity of salmon stocks for inclusion in fishing plans. The linkage between harvest management and fish production, including enhancement as well as habitat protection, needs to be strengthened.

Department's response: The linkage between harvest management and fish production, including enhancement as well as habitat protection, will be strengthened further.

Project Referral System

The project referral system is the primary tool being used to conserve habitat

28.45 The Habitat Policy establishes the project referral system, a six-step procedure for project review to prevent the loss of fish habitat. All projects referred to Fisheries and Oceans are reviewed to determine whether changes to fish habitat are likely to occur if the project proceeds as proposed. Habitat managers make recommendations to project proponents to alter project designs if habitat is likely to be harmed. If this cannot be

avoided, a *Fisheries Act* authorization must be issued, thereby triggering a review under the *Canadian Environmental Assessment Act* (CEAA) — irrespective of the size of the project.

28.46 Land, river and marine foreshore development projects are “referred” by individuals, companies and agencies (federal and provincial) to both the Department and the B.C. Ministry. The potential impacts on fish and fish habitat are determined by departmental and ministry staff based on habitat function, productivity, uniqueness and sensitivity.

28.47 The number of habitat referrals in the Pacific Region has been estimated at 15,000 to 25,000 annually. Although the Department, through the referral process, probably receives the majority of these referrals, we were unable to determine a percentage. These referrals come either directly from proponents or from other provincial and federal agencies. Varying informal arrangements have been made throughout B.C. to deal with the balance of these referrals. The two levels of government have developed, individually and jointly, land development and stream stewardship guidelines, as well as documented procedures for stream-related works, such as dredging and culvert installation, to help proponents plan habitat-friendly projects and thereby reduce the workload of project review and assessment. To this end, the two governments collaborated, for example, on the development of the B.C. Forest Practices Code.

28.48 Referrals range from telephone calls for information to major projects that may involve many hours of work. The Department’s Habitat Referral Tracking System provides up-to-date comprehensive data on referrals for the whole province. It could also serve as a statistical database to assist the Department in evaluating its success in meeting the “no net loss” principle. This is one of the purposes of the documentation collected as part of the referral process, according to the Department’s Habitat Conservation and Protection Guidelines.

Planning is not receiving the emphasis it deserves

28.49 The Habitat Policy, introduced in 1986, established a proactive framework for the management of fish habitat based on integrated resource planning, within which the referral process is a contributing, but not the dominant, component. However, there appeared to be a change in the Department’s strategic approach to habitat conservation and protection with the introduction of the Habitat Conservation and Protection Guidelines in 1994. The Habitat Conservation and Protection Guidelines, while focussing on the project review process, state that staff are “encouraged”, rather than instructed, to enter into planning initiatives whenever possible. The time constraints imposed by the planning process, which often requires evening or weekend meetings if the public is to be accommodated, may have further discouraged extensive participation in planning initiatives at the community level.

The referral process results in some habitat loss

28.50 All projects require an authorization if habitat is to be altered, disrupted or destroyed. If this can be avoided by outlining appropriate conditions, such as the timing of construction or location of a sea wall or breakwater to mitigate the impact on habitat, a “Letter of Advice” is issued to the proponent. The Letter states, however, that it does not constitute an approval under section 35(2) of the *Fisheries Act* for the harmful alteration, disruption or destruction of fish habitat. There is seldom a follow-up visit by a departmental official to ensure compliance even though projects of this type can, and often do, result in minor alterations to fish habitat.

28.51 An accumulation of small habitat losses could result in a significant impact; indeed, such losses are probably the source of the slow net loss of habitat that is occurring. However, there was no information on such cumulative impacts located in the files; nor was there any indication that the Department had conducted periodic assessments on a regional or watershed basis to ascertain whether such cumulative impacts are occurring.

Insufficient attention is given to monitoring and follow-up

28.52 Habitat monitoring is the eighth strategy listed in the Habitat Policy. It requires the Department to monitor the effects on habitat of proposed actions, both during and, for a limited period, after development. In this way, the effectiveness of prescribed conditions of approval, intended to conserve fish habitats, is evaluated and new knowledge acquired. However, without serious attention being paid to this strategy, the long-term conservation of habitat is questionable; the cost/benefit of decisions made and work done is difficult, if not impossible, to assess; and the opportunity to apply lessons learned to increase efficiency and effectiveness is lost.

28.53 The Department's 1993-94 Internal Audit of the Habitat Management Program recognized the Pacific Region's lack of attention to monitoring; however, there was no evidence to suggest that the Department has since corrected this deficiency to any great extent.

28.54 There are two important aspects to monitoring: the monitoring of compliance with terms and conditions attached to the approval to proceed; and follow-up at a later date to assess the effectiveness of those terms and conditions. The Department does carry out some compliance monitoring, but this is limited to about 10 percent for small projects involving mitigative measures. This is not done according to any structured process, but merely when convenient due to workload. For larger projects requiring a section 35(2) authorization, compliance monitoring and reporting are mandatory for the proponent, together with post-project monitoring if deemed necessary by the Department.

28.55 There has been some follow-up activity to assess the long-term effects of habitat alteration. The Department has collaborated with the B.C. ministries of Environment and Forests, industry, universities and First Nations to assess the long-term effects of logging practices on salmon habitat, under the auspices of the Department's Science Strategic Research Program. There have also been a few investigations by consultants who were hired to revisit sites for large-scale projects where habitats were altered, for example, the Coquihalla highway and Jones Creek. Those investigations showed that natural flood conditions could completely destroy certain in-stream structures, raising questions about the effectiveness of prescribed compensation projects over time and the importance of protecting existing habitat.

28.56 Fisheries and Oceans should increase its level of participation in regional and community-based planning initiatives.

28.57 Fisheries and Oceans should work with the Province of British Columbia to improve efficiencies in the referral system, subject to an appropriate accountability framework being put in place to satisfy the Department's national mandate for habitat protection.

28.58 In implementing the referral process, Fisheries and Oceans should devote more time and effort to compliance monitoring and follow-up in order to assess the effects of its habitat management decisions and its performance toward the achievement of "no net loss" of habitat.

(See paragraph 29.93 for Department's response.)

Putting "Partnerships" to Better Use

28.59 In the delivery of its habitat conservation and protection program, the Department relies on the support of and input from a number of internal and external groups. Without their help, the Department would be hard pressed to deliver its mandate. If the Department is to implement a balanced approach to habitat management, comprising both proactive (planning) and reactive (referral process) elements, it needs more involvement from these groups.

Co-ordination of this effort under departmental leadership and within a strategic framework is required to ensure that all are working toward a common objective.

Internal co-ordination is improving but problems still exist

28.60 In order to manage fish habitat within the context of sustainability, there needs to be good internal communication and co-operation between fisheries management and habitat management, between habitat management and habitat science and between habitat management and habitat enforcement. The Department's recent amalgamation of the Salmonid Enhancement and Habitat Management Programs to create the Habitat and Enhancement Branch has improved the situation, but more needs to be done. In discussions with staff, it was apparent that barriers to communication still exist, in spite of efforts to bring the groups together in workshops and other forums. Such barriers contribute to misunderstandings and inefficiency.

28.61 The 1993-94 Peer Review of Habitat Science, conducted as a component of the Internal Audit of the Habitat Management Program, stated that the existing organizational structure is not conducive to integrated planning and analysis in the activity of habitat science research, and even tends to exclude habitat management as a primary client and recipient of this research. More generally, the Review recognized that communication across branches, and within and outside the Science Branch, was not commonplace. Since this study was completed, changes have been made. The management team concept has been endorsed with area managers sitting on the Science Executive Committee, which plays a key role in the development of operational priorities for the science program.

The Salmonid Enhancement Program (SEP) can support genetic diversity and promote proactive habitat management

28.62 The Salmonid Enhancement Program (SEP) has been operating since 1977 and has contributed to overall salmon production in B.C. Enhancement is used to supplement wild stock production and to maintain or create fisheries. While stock restoration has been promoted by the construction of fishways and stream improvements, the major thrust has been through the construction of hatcheries and spawning channels. However, a significant component of the SEP funding also contributes to habitat protection.

28.63 SEP can lead to the maintenance of or an increase in genetic diversity by diverting fishing effort away from the less productive or threatened wild stocks and toward the more productive enhanced stocks. Future activities in this area could concentrate on small enhancement projects using mobile facilities that can respond quickly to provide temporary relief to threatened stocks, especially during periods of low ocean productivity, and thereby contribute to the rebuilding of stocks and the protection of genetic diversity.

28.64 Fisheries and Oceans has made a contribution to habitat protection through its public education and involvement programs, both unilaterally and bilaterally with the B.C. government, using funds from the Green Plan and SEP. For example, it is hard to find a river or stream and associated community in the lower Georgia Strait that have not been affected by SEP. An educational package, highly regarded among educators, is being used in over 200 schools. As of 1995, SEP had put in place 286 small enhancement projects, some stream rehabilitation, side channel improvements and small hatcheries. An estimated 236,000 people had been involved in these activities since SEP began. Furthermore, a "Streamkeepers" public involvement initiative is in place and a manual on stream rehabilitation has been produced.

28.65 SEP is therefore making both a direct contribution to habitat management and an indirect one by sensitizing citizens to the importance of salmon and salmon habitat. This public education initiative will help to bring to the community planning table a more informed public that is aware of the need to protect environmentally sensitive areas and ready to impress on local politicians the importance of such action to the community, the region and the province. Future protection of fish habitat in B.C. will require the involvement of a more informed public.

Continued support for this aspect of SEP is therefore essential to conserve and protect salmon habitat in urban areas, where coho in particular are at risk.

More community involvement in planning is needed

28.66 Under the Fraser River Action Plan (FRAP) and the Habitat Action Plan, several watershed committees have been put in place to promote local decision making and involve stakeholders and the communities in salmon resource issues. Examples include the Quesnel River Watershed Alliance, Salmon River Watershed Roundtable, and the Nicola Watershed Community Round Table. These groups are working well together, according to a report issued by the Department. All of these initiatives are raising the public's awareness of habitat problems and helping to co-ordinate efforts to alleviate them.

28.67 The Province has also recognized the importance of such initiatives and proposes to work with communities and build on the energy of existing volunteer programs to help get the job done. Non-government organizations have made important contributions by being involved in urban stream stewardship activities such as inventorying important wetland habitat in the Fraser Valley, tree planting, lobbying and surveillance activities.

The momentum established by SEP and the Green Plan needs to continue

28.68 Although success has been achieved, the public's appetite for information and involvement has only been whetted. If public education and involvement programs are to be used extensively by governments in habitat management, more information needs to be distributed and standards/guidelines developed to provide direction. Progress has been made to date but, with the end of the Fraser River Action Plan on 30 March 1997, a large gap has opened up. It would be both wasteful and counterproductive to abandon this process now when it has demonstrated such promising potential.

28.69 With the pressures to do more with less, such programs will assume even greater importance. If the goals of the Habitat Policy are to be achieved, the Department needs to look for ways to expand the direct intervention of the public in such activities as planning, compliance monitoring and habitat restoration, which would be subject to departmental audit.

Aboriginal groups have a greater role to play in habitat management

28.70 The Aboriginal Fisheries Strategy (AFS) is making a contribution to habitat conservation and protection. Habitat projects are funded under terms and conditions of formal annual agreements negotiated by the Department with First Nations groups. For example, in 1995-96, 75 agreements were signed at a total cost of \$15.6 million. Of these agreements, 23 had habitat projects listed at a total cost of \$0.8 million. Final reports include an accounting of works and expenditures but there was no accounting of results achieved.

28.71 The AFS has potential as a delivery mechanism for future habitat protection programs. However, the habitat components of the strategy need to be more structured and focussed, and co-ordinated with other habitat activities in the watershed to maximize their contribution to habitat management. Under many agreements, Aboriginal fishery officers are integral to fisheries management activities but not specifically to habitat activities. Local area planning teams provide co-ordination for habitat restoration and protection activities. Standards and guidelines are needed if improvements in habitat surveillance and in the collecting and reporting of habitat data are to be made.

Government Involvement

Governments are becoming more proactive in habitat management

28.72 The Department and the B.C. Ministry of Environment, Lands and Parks currently are represented on several planning groups. These are all contributing to habitat planning at a regional level and, in some instances, such as the Burrard Inlet Environmental Action Program, are assisting in the referral process by serving in a screening capacity and handling land use and mitigation requirements.

28.73 Other groups, such as that involved with the Fraser River Estuary Management Program, have no enforcement powers and depend on government to enforce any terms or conditions imposed by the project review (referral) process. With the exception of the Fraser Basin Council, which covers the Fraser watershed, each group is limited in its area of influence. Co-ordination of such groups is therefore an important responsibility of the senior governments.

Municipalities are supporting planning approaches but problems remain

28.74 Through official community plans and by-laws, municipalities have a direct impact on habitat management. Local governments have control over zoning and most land development. It is land development that has the primary impact on ecosystems in urban environments. Municipalities, through such provincial acts as the *Municipal Act*, *Land Titles Act*, *Local Services Act* and its Subdivision Regulation, *Health Act* and *Growth Strategies Act*, have the tools to protect the environment if they choose to do so. In addition, official community plans can protect local ecosystems through the use of density bonus zones, comprehensive development areas, and development permit areas.

28.75 Progress has been made at the municipal level, especially in land use planning. A number of municipalities have designated environmentally sensitive areas in their official community plans. The Department is involved in the review of those plans and regional plans. Identification and designation of environmentally sensitive areas is one of the most important tools for the protection of aquatic and riparian resources and their habitat.

28.76 The Department is a signatory to a few memoranda of understanding (MOUs) with municipalities, such as the Corporation of the District of North Vancouver. MOUs are currently under discussion with Coquitlam, Surrey and Langley. Those municipalities plan to support the work of Environmental Review Committees by clarifying roles, responsibilities and resources for environment protection.

28.77 These developments are encouraging, but there are still problems to be resolved. For example, a report commissioned by Fisheries and Oceans on the Comox-Strathcona Watershed Committee, established in 1995, noted a lack of willingness by the Department to move away from a reactive referral system process toward a more proactive land use planning approach that is able to use the information provided by the participants.

28.78 Municipalities have raised a number of concerns, such as a reluctance to incorporate fish habitat protection into their by-laws, because they do not feel technically competent, do not want federal responsibilities, and worry about additional expenses. Furthermore, they have requested more habitat information and standards from the senior governments. Less than half of municipal governments have established regulatory guidelines and measures that could be implemented. The review of audit files yielded only one example of a municipality, the District of North Vancouver, that has actually incorporated the Land Development Guidelines into its by-laws. As the Department has no authority to require municipalities to adopt guidelines, it must convince them of the benefits of doing so.

Accountability Is Needed

Accountability for delegated habitat management responsibilities is lacking

28.79 Some agreements are in place to co-ordinate departmental and provincial efforts to protect fish habitat. Such arrangements are not subject to monitoring and audit by the Department even though it is ultimately responsible for habitat conservation and protection. Previous Reports of the Auditor General noted that there was a drop in compliance by project proponents when monitoring and enforcement of fish habitat provisions were carried out by the provinces.

28.80 Two recent reports, one on compliance with stream protection provisions under *The Forest Practices Code Act* and the other a preliminary report on compliance with urban development by-laws, indicate that problems still exist in the absence of adequate compliance monitoring by government.

28.81 The Department needs to audit monitoring activities in the provincial and municipal areas, or to negotiate agreements with the other levels of government to ensure that the requirements of the *Fisheries Act* are met and that the Department receives regular progress reports according to an agreed accountability framework. No such framework currently exists, although Fisheries and Oceans receives some information through the co-operative arrangements in place. An example of such a framework is given in Exhibit 28.5.

Exhibit 28.5

Framework for an Accountability Arrangement

Element	Description	Where Found
Clear expectations	The objectives being pursued, the accomplishments expected and the rules to be followed should be explicit, understood and agreed to.	Mission, Mandate and Objectives
Clear roles and responsibilities	The roles and responsibilities of the parties in the accountability relationship should be well understood and agreed to.	Obligations of Contracting Parties
Balanced expectations and capabilities	The performance expectations should be balanced by the commensurate capacities (authorities, skills and resources) of each party.	Legal Framework Authorities
Credible reporting	Credible and timely information should be reported to demonstrate the performance achieved and what has been learned.	Performance Measures Reporting Regime
Reasonable review and adjustment	Enlightened and informed review and feedback on the performance achieved should be carried out by the accountable parties, where achievements and difficulties are recognized and necessary corrections made.	External Auditor's Report Review and Redress Mechanisms

The 1985 General Fisheries Agreement has no provision for accountability

28.82 The General Fisheries Agreement was intended to foster co-operation. Included in its strategy section is a provision for the development of guidelines that would describe processes and procedures to be followed by both

the provincial and federal governments in dealing with specific issues raised. However, there is no evidence that accountability was formally addressed under the Agreement. Furthermore, the memoranda of understanding that were developed under the Agreement make no reference to accountability.

Proposed changes to the *Fisheries Act* could deal with the accountability problem

28.83 The Department's Report to its Minister on the National Habitat Delegation Workshop held in November 1996 states that monitoring is one of the recognized criteria for delegation of habitat responsibilities. There was general agreement that the Department should take the lead role in determining and defining the objectives, methodology and timelines for monitoring and evaluation, including conducting audits. Clear and public reporting mechanisms were seen to be necessary to ensure accountability.

28.84 In the debate in Parliament over the introduction of amendments to the *Fisheries Act*, the Minister of Fisheries and Oceans said that those provinces that receive delegated responsibility for fish habitat will be required to show that they are meeting national habitat protection standards. This will be demonstrated by an appropriate accountability framework, including reports to the federal government on the status of habitat and periodic federal audits of their performance. Such accountability would demonstrate the Department's leadership and control in habitat conservation and protection, in keeping with its national mandate.

28.85 Fisheries and Oceans should review the performance of existing co-operative arrangements in B.C. and build on those models that have produced positive results in habitat conservation.

28.86 Agreements setting up such co-operative arrangements should contain a statement of objectives, a clear definition of roles and responsibilities, expected results and requirements for program co-ordination, performance reporting and evaluation.

(See paragraph 28.93 for Department's response.)

Canada-B.C. Relations

There is an opportunity to enhance Canada-B.C. relations

28.87 The Minister of Fisheries and Oceans is seeking to share responsibility, decision making and management of costs with fisheries groups through long-term partnership agreements. This follows the considerable interest expressed by stakeholders in direct involvement in fisheries management. The matter has assumed greater prominence due to the recent federal-provincial negotiations on salmon management in B.C.

28.88 The Canada-B.C. Agreement on the Management of Pacific Salmon Fishery Issues, signed in April 1997, provides for a stronger federal-provincial commitment to the protection of fish stocks and to habitat restoration and protection. Policy initiatives will be reviewed and co-ordinated through a Council of Fisheries Ministers. A Pacific Fisheries Resource Conservation Council will advise the Fisheries Ministers on the conservation and long-term sustainable use of salmon resources and habitat. It is also expected to report publicly on the status of the salmon resource and its habitat. As part of this Agreement, the Department is devoting new funds to stewardship initiatives under the Pacific Salmon Revitalization Strategy.

The Province has released its fisheries strategy

28.89 The first step in implementing the provisions for habitat protection under the new Canada-B.C. Agreement is for the two governments to develop joint objectives and a strategic framework embodied in working agreements

to achieve those objectives. The Province released its discussion paper, The B.C. Fisheries Strategy, in May 1997. It names conservation as the first guiding principle and saving the fish as its first priority. It states that habitat must be protected and restored in every salmon-bearing river and stream. The Department's current policy goal is to achieve a "net gain" of productive habitat through the guiding principle of "no net loss" applied on a project-by-project basis. The positions of the Province and the Department are similar and both support the maintenance of genetic diversity. However, the Department is not preventing habitat loss under the current referral system, and protecting fish habitat stream by stream may be equally difficult. If the main objectives of both governments can be reconciled, there would be the basis of a joint approach around which a strategic framework for the protection of the resource and its habitat could be built.

28.90 The new Agreement recognizes areas of current co-operative action between the two governments. For example, it seeks ways to improve the handling of referral workloads to avoid overlaps, and suggests administrative measures to streamline the process, such as cross-delegation of authority between governments, and collocating of staff within common administrative boundaries for watershed-based activities and processes. The Agreement also recognizes the need to bring decision making on salmon resources and habitat closer to clients and stakeholders. Major new policy initiatives will be developed in consultation with stakeholders, through a jointly agreed stakeholder group. The group will advise the Council of Fisheries Ministers on habitat restoration and enhancement matters through a Fisheries Renewal Advisory Board.

The Department needs to review its Habitat Policy

28.91 Fisheries and Oceans has not conducted a review of the effectiveness of its Habitat Policy to conserve and protect habitat since its introduction in 1986. It is our understanding that the Policy will be incorporated into the Department's Sustainable Development Strategy and Action Plan to be tabled in the House of Commons by December of this year. Thus the Policy's goals, objectives and strategic approach to habitat management will be open for public discussion.

28.92 There is an opportunity, therefore, for Fisheries and Oceans to lay out the elements of a strategic framework for the management of salmon fisheries and habitat management, much as the Province has done in its document, and to obtain the public's views on it. The response to the Department's proposals could then be used to formulate a departmental position for the upcoming negotiations with the Province.

28.93 Fisheries and Oceans should review the effectiveness of its Habitat Policy and habitat management program and develop a strategic approach to guide its negotiation of a new sub-agreement on habitat conservation and protection with British Columbia.

Department's response: Fisheries and Oceans is undertaking an internal review of the habitat management program in the Pacific Region to provide strategic direction for program delivery. This review is a component of the 1997 Canada-B.C. Agreement, which is expected to result in a co-ordinated and balanced habitat management program in B.C.

Conclusion

28.94 Pacific salmon stocks and habitat are under stress. While the *Fisheries Act* and Habitat Policy provide the necessary legislative base for the Department to manage Pacific salmon and their habitat for sustainability, results indicate that this is not being fully achieved. The development of its Sustainable Development Strategy and Action Plan could provide the opportunity for the Department to address problem areas raised by this audit.

About the Audit

Objective

Our audit objective was to determine if the Pacific salmon resource was being managed to ensure its conservation and sustainability.

Criteria

We expected that the Department would:

- have adequate databases on fish habitat and stock assessment that would be accessible to and used by decision makers;
- have a science program to determine the fish production of major freshwater and marine habitats;
- be applying the *Fisheries Act* and regulations and specifically the Policy for the Management of Fish Habitat to achieve the stated goal of “net gain”, first, by applying the guiding principle of “no net loss” and, second, by enhancing habitat where feasible;
- be using the Salmonid Enhancement Program and the Aboriginal Fisheries Strategy to support the sustainability of the resource base; and
- have entered into partnerships wherever and whenever possible to improve its efforts to protect fish habitat and enhance fish production in areas outside its jurisdiction, and to maximize benefits from resources at its disposal.

Approach

Our examination involved meetings or telephone conversations with departmental staff in headquarters in Ottawa, in the Pacific Region Office in Vancouver and in the district offices in Nanaimo (Vancouver Island) and New Westminster. We reviewed Fisheries and Oceans files and documentation as well as external reports relating to Pacific salmon from a number of sources.

Audit Team

Geoffrey Robins
John Sokolowski
Gregory Springate
Deborah Irwin

For information, please contact John McCullough, the responsible auditor.

Chapter 29

Industry Canada

Management of the Small Business Loans Program

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Industry Canada

Management of the Small Business Loans Program

Assistant Auditor General: Richard Flageole

Responsible Auditor: Harry A. Ruthnum

Main Points

29.1 Small businesses play a very important role in our economy. In 1994, more than 98 percent of all businesses in Canada were small businesses with fewer than 50 employees. In 1995, small businesses contributed 43 percent of Canada's private sector economic output. However, the lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.

29.2 The objective of the Small Business Loans Program is to increase the availability of loans for establishing, expanding, modernizing and improving small business enterprises. New lending under the Program will end on 31 March 1998 unless the government decides to renew it. This presents an opportunity to better define the results expected from the Program and to improve performance measurement. As part of the decision to renew the Program, it will be important to take into account the needs of small businesses in a changing Canadian economy and business environment. The dual objectives of increasing the availability of loans at reasonable rates while recovering all the costs need careful analysis.

29.3 The Small Business Loans Program will incur a net loss estimated at \$210 million for loans issued between 1993 and 1995. The Program is now moving toward full cost recovery; however, under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved. Careful monitoring and better systems to forecast the future performance of the Program are needed.

29.4 Industry Canada requires lenders to comply with the *Small Business Loans Act* and Regulations and to exercise due care when making loans. The Department needs to strengthen its claim audit procedures to obtain assurance of such compliance. It also needs to take steps to minimize the interest it is paying on claims submitted by lenders. The intent of the Act regarding lending to related borrowers requires clarification.

29.5 It is important that the Department provide Parliament with the information necessary to assess whether the Program is managed efficiently and is achieving its objectives. In addition, more rigor is needed in evaluating the Program's impact on job creation.

Introduction

Small businesses make a significant contribution to the Canadian economy

29.6 In 1994, more than 98 percent of all businesses in Canada were small businesses with fewer than 50 employees. In 1996, one out of two Canadians was employed in a small business. Moreover, it is well recognized that small businesses account for a greater share of employment creation than their share of existing employment.

29.7 Small businesses play a very significant role in our economy. In many regions of Canada, they are at the heart of economic activity and community development. In addition, they sometimes develop into large firms of the future. Small businesses contributed 43 percent of Canada's private sector economic output in 1995.

29.8 Management experience, market access, availability of financing, application of technology, and fiscal and monetary policies are all important factors that contribute to the success of small businesses. Financing, however, is vital for a small business, particularly in its early years. Typically, the initial capital comes from the owner or from family and friends. Much of the additional equity comes from the earnings of the business. The other significant source of financing is through borrowing, primarily from the chartered banks, caisses populaires, credit unions and trust companies. The lack of financing on reasonable terms and conditions has often been identified as a significant barrier to the growth of small businesses.

29.9 Governments in industrialized nations have traditionally played an important role by offering financing and/or guarantees to improve access to capital, with the objective of creating jobs and stimulating economic growth. As well, governments have become involved in small business financing to counter the negative effects of downturns in business cycles. One of the initiatives that the federal government has introduced to achieve these objectives is the Small Business Loans Program.

29.10 The Small Business Loans Program is one of several federal programs aimed at providing assistance to small businesses. For example, some programs of regional development entities, and the *Farm Improvement and Marketing Co-operative Loan Act* are designed to cover lenders' losses on loans to small business. The Business Development Bank of Canada also provides direct financing to small businesses. Two provinces have programs that are similar to the Small Business Loans Program.

Objective and operation of the Small Business Loans Program

29.11 The Small Business Loans Program was established in 1961 to provide loan guarantees to private sector lending institutions. The Program aims at encouraging lenders to make loans, on reasonable terms and conditions, for the establishment, expansion, modernization and improvement of small business enterprises, by offsetting a portion of the lenders' net losses in the event of default of a guaranteed loan. The Program is well known among the small business community and financial institutions. Exhibit 29.1 outlines the main changes to the Program since its inception in 1961 to the latest revision in 1995. The Program is subject to a sunset clause and has been renewed many times since 1961 for specified lending periods. New lending under the Program will end on 31 March 1998 unless the government decides to renew it.

Exhibit 29.1

Major Changes to the Small Business Loans Program

1961	<ul style="list-style-type: none">• Creation of the Program.• The Program was delivered by the Department of Finance.• Chartered banks were the only eligible lenders.• The maximum loan amount was \$25,000.
1970	<ul style="list-style-type: none">• Credit unions, caisses populaires and other co-operative societies, trust, loan and insurance companies became eligible to lend.
1971	<ul style="list-style-type: none">• Eligible small businesses were defined as businesses with less than \$1 million in revenues.• The maximum loan amount increased to \$50,000.
1974	<ul style="list-style-type: none">• The Province of Alberta Treasury branches were added as eligible lenders.
1977	<ul style="list-style-type: none">• Eligible small businesses were defined as businesses with less than \$1.5 million in revenues.• The maximum loan amount increased to \$75,000.
1978	<ul style="list-style-type: none">• The responsibility for the Program was moved to the Department of Industry, Trade and Commerce.
1980	<ul style="list-style-type: none">• The maximum loan amount increased to \$100,000.
1985	<ul style="list-style-type: none">• Eligible small businesses were defined as businesses with less than \$2 million in revenues.• A 1% registration fee was introduced.
1993	<ul style="list-style-type: none">• Eligible small businesses were defined as businesses with less than \$5 million in revenues. Firms in particular sectors (including the professions) became newly eligible.• The maximum loan amount increased to \$250,000.• The percentage of financing permitted increased to 100% from 80% on equipment and 90% on land and buildings.• The maximum rate of interest increased to prime plus 1.75% from prime plus 1%.• The amount of government guarantee increased to 90% from 85%.• The registration fee was increased to 2%.
1995	<ul style="list-style-type: none">• The percentage of financing permitted was reduced to 90% (for loans made after 31 December 1995).• The maximum rate of interest was not to exceed prime plus 3%.• A 1.25% annual administration fee was introduced.• The amount of government guarantee for lenders was reduced to 85% (for loans made after 31 December 1995).

29.12 Guaranteed loans are available to all businesses with sales not exceeding \$5 million, with the exception of farming, religious and not-for-profit organizations. The maximum amount that can be loaned under the Program at any time is \$250,000 per borrower. This amount can be used to finance up to 90 percent of the purchase or improvement of land, buildings and equipment. The maximum repayment period for a loan is 10 years. Small business loans are not available for acquiring shares; purchasing inventory, goodwill or intangible assets; financing working capital; or refinancing existing debt.

29.13 Lending institutions make loans directly to borrowers and are responsible for all aspects of credit management, including realizing security pledged against a loan if the borrower defaults. Lenders are allowed to obtain personal or corporate guarantees. The personal guarantee is unsecured and cannot exceed 25 percent of the loan amount. Borrowers pay an up-front fee of two percent of the amount borrowed at the time of the registration of

the loan guarantee. Lenders pay an annual administration fee of 1.25 percent on the average monthly outstanding balances for loans issued after 31 March 1995. This administration fee may be passed on to borrowers through an increased interest rate. In the event of default of a guaranteed loan, the Program pays to the lender 85 percent of the net amount in default. The maximum loan loss that can be reimbursed to an individual lender is generally limited to 10 percent of all its guaranteed loans registered. Rates charged by lenders cannot exceed prime plus three percent for a floating rate loan, or applicable residential mortgage rates plus three percent for a fixed rate loan.

29.14 The Small Business Loans Administration Directorate of Industry Canada is responsible for loan guarantee registrations, for ensuring that lenders and borrowers comply with the *Small Business Loans Act* and Regulations, and for processing lenders' claims for loans in default. It had a staff of 35 and an administrative budget of \$2.3 million in 1996-97. The Department's Entrepreneurship and Small Business Office provides overall strategic direction for the Program.

29.15 The regional development entities — the Atlantic Canada Opportunities Agency, the Federal Office of Regional Development - Quebec, and Western Economic Diversification Canada — are charged the respective costs incurred by Industry Canada for claim payments, net of fee revenues, made within their jurisdictions.

The level of activity has increased significantly since 1993

29.16 Important amendments to the *Small Business Loans Act* were implemented in 1993 to broaden eligibility criteria, increase the amount of financing made available and reduce personal guarantee requirements. Further amendments were made in 1995 to reduce the percentage of financing permitted and the loss-sharing ratio, to introduce an annual administration fee and to increase the maximum rate of interest. As shown in Exhibit 29.2, the level of activity increased dramatically in the two years that followed the 1993 amendments and diminished thereafter.

Exhibit 29.2

(This exhibit is not available, see the Report)

29.17 In the last four years, some 177,000 new loans have been guaranteed for a value of approximately \$11.2 billion. The 1997 federal Budget increased the authorized ceiling for loans that can be issued from \$12 billion to \$14 billion. The total amount of guaranteed loans outstanding at 31 March 1997 was \$6 billion, of which the government was contingently liable for a maximum of \$1.4 billion.

29.18 The Program is generally used to finance new and early-stage (one to three years old) enterprises. As shown in Exhibit 29.3, 66 percent of new loans issued in 1996-97, in terms of value, were for newly created businesses (47 percent) and enterprises that had been in existence for less than three years (19 percent).

Exhibit 29.3

(This exhibit is not available, see the Report)

29.19 The chartered banks issued \$1.5 billion or 78 percent of the loans guaranteed during 1996-97 (see Exhibit 29.4). They held \$4.8 billion or 80 percent of the total outstanding loan guarantees at 31 March 1997. Loans outstanding under the Program represented more than 20 percent of commercial bank lending for amounts of less than \$250,000.

Exhibit 29.4

(This exhibit is not available, see the Report)

29.20 As shown in Exhibit 29.5, the level of claims has also increased significantly since 1993. Between 1 April 1993 and 31 March 1997, Industry Canada paid 8,217 claims amounting to \$274 million and received fees of \$233 million. Of the claims paid in 1996-97, one half related to loans issued in 1994-95 and approximately one third related to 1993-94 loans (see Exhibit 29.6). Nearly 75 percent of the value of claims paid was for loans made to new businesses.

Exhibit 29.5

(This exhibit is not available, see the Report)

Exhibit 29.6

(This exhibit is not available, see the Report)

The small business sector has been the subject of much recent study

29.21 Many studies on the small business sector have been carried out in recent years. At the federal level, the 1994 Department of Finance and Industry Canada joint report "Growing Small Businesses" referred to the growth of small business as essential to job creation in Canada. The report also identified access to capital as a critical issue and noted the importance of a positive business environment to small business growth. It set out the approach that the government intended to take to create this environment primarily by working closely with other economic players and introducing new policies and programs to support small business.

29.22 The October 1994 House of Commons Industry Committee report "Taking Care of Small Business" stated that the Small Business Loans Program should continue to provide support to small businesses. The Committee expressed concerns, however, about the increasing costs of the Program and stated that any changes should consider not only costs but also the significant benefits. It raised the issue of a possible preference given by the Program to banks over other lenders. The Committee also believed that the government guarantee should be used to increase the availability of credit rather than to allow lenders to reduce their risk on loans that they would have made without the guarantee.

29.23 In November 1994, the Small Business Working Committee, set up by the ministers of Finance and Industry and made up primarily of representatives from small business, released a report entitled "Breaking Through Barriers". This report highlighted some significant challenges that small and medium-sized enterprises face. One of these challenges is obtaining suitable financial support to expand. The report stated that without adequate financing, growth of these businesses would be stunted and the future prosperity of Canada could be threatened. The Committee recommended a series of initiatives to provide a sound basis for small business growth and development. Those initiatives included increasing financial institutions' participation in debt financing, together with using the government's leverage to encourage competition among financial institutions to significantly increase their appetite for lending in the small business market.

29.24 Financial institutions have responded to these government reports with new initiatives. All of the major banks and several other financial institutions have introduced new services or products for small and medium-sized businesses in recent years. Many of these products have been the result of joint efforts among the financial institutions, the federal regional development entities and the Business Development Bank of Canada.

29.25 In addition, the Canadian Banking Association has developed quarterly business credit statistics that provide an ongoing view of the small business lending in Canada. It has also developed an alternative dispute resolution process and a code of conduct for dealing with small businesses. As well, each of the banks has appointed an ombudsman to handle complaints from small businesses. Finally, in 1996, a banking industry ombudsman was appointed to address small business complaints that individual banks were not able to resolve.

Focus of our audit

29.26 The objective of our audit was to determine whether Industry Canada has the systems and practices in place to assess whether the Small Business Loans Program is delivered efficiently, in a cost-effective manner and in accordance with the *Small Business Loans Act* and Regulations. Further details on the audit objective, scope and criteria are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Objectives of the Program and Evaluation of Results

Clear statements of expected results are needed

29.27 The primary objective of the Small Business Loans Program, according to the *Small Business Loans Act* (SBLA), is to increase the availability of loans for establishing, expanding, modernizing and improving small business enterprises.

29.28 Increasing access to financing is a very broad objective. Since legislative program objectives are often stated in general terms, it is important for program managers to ensure that results expected from the Program are clearly defined.

29.29 The eligibility criteria and the conditions of the Program are stipulated in the *Small Business Loans Act* and Regulations. A major part of the Program is delivered by third parties — private sector financial institutions. It is important to note that, in such circumstances, program managers do not have the same level of discretion in influencing the ongoing delivery of the Program as when they are delivering directly to the client.

29.30 Nevertheless, Industry Canada is responsible for ensuring that the Program is designed in a way that will maximize its intended impact, and that expected results are achieved. Clear statements of expected results are prerequisites to sound program design and enable the Department to measure actual results.

29.31 Industry Canada has developed indicators to monitor the level and type of activities under the Program. It compiles various operational statistics, such as the number, type and value of loans guaranteed, the number and value of claims paid, and the age of businesses using the Program. Information is also available, for example, on lending by region, type of lenders and size of business.

29.32 These data are very useful to provide information on the Program's activity — that is, the volume of loans and the characteristics of borrowers and lenders. They do not, however, provide sufficient information on the results being achieved by the Program.

29.33 Industry Canada collects and reports information on job creation under the Program. Job creation is one indicator of the degree of success of the Program. There are, however, other important results, some of which might even have a negative impact on job creation. For example, the provision of loans for modernizing small businesses may in fact reduce the level of employment in some cases. However, in such cases other significant benefits may be achieved by increasing the level of productivity and reducing production costs, leading to increased competitiveness.

29.34 We believe that *SBLA* program managers would benefit from defining clear statements of expected results within the framework of the broad legislated Program objectives. For instance, it would be important to clarify expectations and to develop performance indicators regarding the objectives of establishing, expanding, modernizing and improving small businesses. Such expectations could address, for example, level of sales, profitability, productivity, competitiveness, level of exports, product development, net employment impact and overall business success.

29.35 The 1994 report entitled “Taking Care of Small Business” stated that the Program should be reviewed with respect to its costs and benefits. Several studies of the Program have been done over the last 10 years. None of these studies or reviews contained a complete cost/benefit analysis of the Program, and none can be considered a complete program evaluation.

29.36 Eligibility requirements and conditions of a program such as the Small Business Loans Program will, by their nature, affect the achievement of specific results. For example, by setting the types of assets to be financed, the loss-sharing ratio and the fee structure, the Program will have a significant impact on the potential users and the extent to which objectives will be achieved. Clear statements of expected results would help program managers establish a clear direction for the Program and ensure that its eligibility criteria and conditions maximize its impact while meeting the evolving needs of small businesses.

29.37 Industry Canada should:

- **define clear statements of expected results for the Small Business Loans Program; and**
- **obtain relevant information on the results achieved by the Program.**

Department’s response: Since 1961, the Small Business Loans Act (SBLA) has had a clearly expressed objective of increasing the availability of loans for financing small business. As noted by the Auditor General, Industry Canada has been conscious of the need for ongoing monitoring of program performance and has commissioned extensive studies to effectively manage the Small Business Loans Program. Industry Canada is also updating the program evaluation framework concurrently with the proposed review of the SBLA, and intends to conduct this evaluation at an appropriate point.

There is a need to ensure that Program design is optimal

29.38 Clear statements of expected results, and information about actual performance are crucial when decisions are made about changes to a program. We noted that some changes have been made to the Small Business Loans Program over the years; however, the extent to which evaluations of previous results have had a significant influence on those changes is not clear. Without precise expectations and information on actual results achieved, there is a risk that program design decisions will not be made on a timely basis or will be unduly influenced by considerations other than those related to the fundamental reasons for the Program’s existence.

29.39 There has been much discussion in recent years about the level of incrementality achieved by the Program — that is, the proportion of loans that would not have been made in its absence. Incrementality is central to the purpose of this Program.

29.40 Over the past five years, studies have been done on behalf of Industry Canada on the level of incrementality of *SBLA* loans. A 1994 study indicated that between 30 and 40 percent of *SBLA* loans were made to firms that would have received financing from lenders anyway. The latest study, in 1996, indicated that approximately 54 percent of the loans to small businesses, particularly to newly created enterprises, could be

deemed as incremental. Given the objective of the Program and the impact of incrementality on its design, we believe it is important for Industry Canada to define the expected level of incrementality of *SBLA* loans.

29.41 As discussed in paragraphs 29.48 to 29.50 of this chapter, Industry Canada has placed considerable emphasis in the last two years on moving toward full cost recovery for the Program. We consider that the dual objectives of increasing the availability of loans at reasonable rates while recovering all costs need careful analysis.

29.42 We expect that, in future assessments of the Program, the Department would study thoroughly the extent to which these two objectives are simultaneously achievable.

29.43 The strategic direction of the Small Business Loans Program has not changed much in the last 36 years. At the time of the original legislation in 1961, the Canadian economy was based much more on manufacturing. The Program then dealt with the issue of the lack of term financing for equipment and leasehold improvements. Although the Canadian economy has evolved significantly since that time, the legislation governing the Program has remained essentially unchanged with respect to the types of assets eligible for financing. The service sector and the knowledge and information sector form a much greater part of the economy today, with the latter sector having a high net employment growth. However, the Program is still directed toward the financing of capital assets (land, premises and equipment).

29.44 In recent years, financial institutions have introduced new services and new products for small businesses. In an increasingly competitive financial market environment, market forces could lead to a better response to the financing needs of small businesses. The need for the Program to meet any financing gaps in the market for small businesses may therefore change significantly.

29.45 New lending under the Program will end on 31 March 1998 unless the government decides to renew it. As part of that decision, it will be important to take into account the needs of a changing Canadian economy and business environment. The challenge for program managers is to clearly state what this Program is meant to achieve in supplementing services already or potentially available from private sector lenders, and to design a program with eligibility requirements and conditions that will maximize its impact in closing identified gaps in the market.

29.46 **Industry Canada should ensure that the *Small Business Loans Act* eligibility requirements and conditions lead to the achievement of the results expected from the Program.**

Department's response: The Program's eligibility requirements and conditions will be reviewed in depth as part of the proposed review of the Small Business Loans Act.

Objective of Full Cost Recovery

29.47 The Small Business Loans Program has made net cash payments of \$339 million between its inception in 1961 and 31 March 1993. Industry Canada has reported a combined surplus of \$72 million, on a cash basis, for fiscal years 1993-94 and 1994-95. However, in its 1995-96 annual report, the Department recognized the likelihood of a considerable increase in claims for losses in the next four years. The Department does not expect these increased claims to be fully offset by revenues but has provided no estimate of the shortfall. Our estimate is that the Program will incur a net loss of \$210 million associated with loans issued between 1 April 1993 and 31 March 1995. That estimate was determined by deducting the fee revenues (\$139 million) from the government's share of the claims paid (\$182 million) and projected claims (\$167 million) on the loans issued during that period. The net loss is funded by the government.

The Program is moving toward full cost recovery

29.48 Industry Canada introduced a policy of full cost recovery for loans made after 1 April 1995. At the same time, the Department's loss-sharing ratio was reduced from 90 percent to 85 percent. Another major change included the introduction of a 1.25 percent annual administration fee, based on the average amount of loans outstanding. According to departmental projections, this should result in full cost recovery over a 10-year period.

29.49 We noted, however, that since 1994-95 the guarantee portfolio contains an increasing proportion of higher-risk loans. For example, we noted an increase in loans to newly created enterprises. In 1996-97, 75 percent of claims against the Program guarantees were for loans that had been issued to start-up companies.

29.50 An internal study conducted for the Department at the beginning of 1997 also indicates a significant increase in the risk of the *Small Business Loans Act* portfolio during the last two years. The study states that higher default rates are being experienced in 1997 and these defaults are generally occurring earlier in the life of the loans. We believe that program managers need to factor into their projections of future default rates the increased level of risk in the portfolio and the impact of a possible eventual downturn in the business cycle. We consider that under the present fee structure and loss-sharing ratio, it is uncertain whether full cost recovery will be achieved.

29.51 The Department should carefully monitor any developments in the performance of its guarantee portfolio that would prevent it from achieving its financial objective of full cost recovery.

Department's response: Industry Canada has been carefully monitoring, through data collection, its move toward cost recovery for all loans made since 1 April 1995. An enhanced statistical model to monitor cost recovery is being designed for implementation in 1998-99.

Systems and practices to forecast future performance of the Program need to be strengthened

29.52 We expected that Industry Canada would have the capacity and resources and would have developed systems and practices to collect and analyze, on a timely basis, the requisite information to forecast the performance of the Program. This is required in order to monitor the risk exposure of the loan guarantee portfolio and to support the financial objective of full cost recovery.

29.53 In recent years, Industry Canada has carried out a number of studies on the performance of its loan guarantee portfolio. The Department has used the information from these studies in assessing loan performance and setting fees. The studies have also taken into consideration the overall economic trends and changes in the guarantee portfolio.

29.54 We believe, however, that more needs to be done to forecast default levels. For example, the Department needs to carry out regular analysis of its guarantee portfolio, including loans by industry, region, age of business, lender and type of asset. Overall economic trends will need to be factored into such analysis.

29.55 In 1994, Industry Canada initiated a project to develop a model to forecast the financial performance of the Program. This model is being revised to include program parameters such as type and size of business, as well as economic indicators. It will be important to periodically obtain information from lenders on loan impairment rates to validate results obtained from the model. As well, it will be important to obtain the resources required to analyze the information necessary for ongoing monitoring.

29.56 Industry Canada should pursue its efforts to develop systems and practices to forecast the future performance of the Program.

Department's response: Further to our response to paragraph 29.51, an enhanced forecasting model and related systems to monitor cost recovery are being designed for implementation in 1998-99.

Delivery of the Program

29.57 Good credit risk management by lenders is critical to maintaining the quality of the guarantee portfolio. Credit risk is the risk of loss arising from borrowers who fail to repay their loans. The Program has been structured so that the credit risk is managed by the lending institutions. The expectations are that they will ensure that loans comply with the eligibility requirements and conditions of the Program, and that they will make lending decisions with the same degree of due care and diligence as they do with their other loans that are not guaranteed under the Program. We expected that Industry Canada would have the mechanisms in place to obtain assurance that lenders are meeting those expectations.

Claims from lenders need to be more carefully assessed

29.58 Industry Canada obtains assurance on the quality of credit risk management procedures by focussing on claims submitted for payment. The Department reviews every claim that lenders submit to determine if the loan has been issued in accordance with the *Small Business Loans Act* and Regulations. This review is intended to determine whether the loan meets Program eligibility criteria such as the size of the business, its business activities, the type of asset financed, and the terms of the loan. The review also includes an assessment of the information related to the realization of collateral or security.

29.59 Up to 31 March 1997, the Department indicated that it had received claims of \$299 million relating to loans issued after 31 March 1993. The payments made on these claims amounted to \$206 million, or 69 percent of claims received. The balance of claims were either reduced or rejected.

29.60 The exercise of due care when making loans is a fundamental requirement outlined in the "*SBLA Guidelines for Lenders*". We noted, however, that as part of its review, Industry Canada does not assess whether the lender has exercised due care when making a loan. This may result in the Department making payments for claims related to loans where the lender has not exercised the expected due care. The illustrative case studies on pages 18 and 19 provide examples of a loan for which a claim has been made (Case Study 1) and a loan for which all debt obligations have been met (Case Study 2).

29.61 We reviewed a statistical sample of lenders' loan files both for outstanding loans and for loans that had defaulted and had subsequently been the subject of a claim to Industry Canada. Our objective was to assess the quality of the review process that lenders follow when approving *SBLA* loans.

29.62 We noted that lending institutions had similar policies for both *SBLA* and non-Program loans. We focussed our review on the key aspects of a rigorous loan analysis — that is, the assessment of management capability, market potential and financial viability. We looked for evidence of appropriate analysis in the files, such as a business plan, an analysis of market potential, information on the competition, financial statements and projections and an analysis of the borrower's ability to repay the loan.

29.63 We found that, in some instances, the loan files did not contain the information necessary to perform a thorough credit risk analysis. These files were mainly lacking information such as a business plan, a market analysis and financial projections. We consider that Industry Canada needs to encourage lenders to assess their *SBLA* loans more carefully. It also needs to increase its level of assurance that lenders have applied the expected due care in reviewing loans submitted for claim payments.

29.64 Industry Canada does not request access to the complete loan file when it receives a claim. Therefore, the Department does not have the information to identify some cases of non-compliance with the *Small Business Loans Act*. More specifically, we found in our review of loan files a number of cases where, contrary to the Act, the lender had charged administration fees. Such non-compliance makes a loan ineligible under the Program. We also found a number of cases where lenders had charged fees for a financing package that included *SBLA* and non-Program loans. We could not determine if a portion of the fee was applicable to the *SBLA* loan. However, we noted some cases involving high administration fees even though the non-Program portion of the financing package was not significant.

29.65 Finally, we noted significant variations among the rates of claims submitted by different lenders. Various explanations exist for these variations, for example, differences in the rate of incremental loans. However, a higher rate of claims from a particular lender could also be an early warning that the lender is not exercising due care in assessing loans under the Program. Another indicator is the higher proportion of impaired loans within a lender's *SBLA* portfolio. Consequently, such indicators could be considered by Industry Canada in formulating an effective strategy to ensure that lenders are making *SBLA* loans with due care.

Illustrative Case Studies

To understand better the intent of the Small Business Loans Program and the contribution that it makes to small business financing, we present two case studies. Case Study 1, a small business, has been unable to pay off its loan and a claim has been made under the Program. Case Study 2, another small business, has received a loan guaranteed under the Program and, to date, has been successful.

Case Study 1 — An Example of a Loan for Which a Claim Has Been Made

Loan	\$250,000
Industry	food services
Employees	12
Forecast annual sales	\$700,000
Age	new
Assets	\$330,000
Equity	\$80,000
Purpose of loan	to buy furniture, equipment and make leasehold improvements to start a new restaurant
Alternative sources of financing	significant personal net worth of the owners

In early 1995, the owners opened a restaurant in the downtown area of a major Canadian city. They leased space, making necessary improvements to the leasehold, and acquired equipment and furnishings. The

restaurant was a franchise. The market for the product and service was unknown. Neither of the owners had any previous experience in the food services industry. A cash forecast was developed, and a franchise document was provided, but no business plan was prepared. The assets financed were for the most part leasehold improvements. Loan financing came from a \$250,000 loan through the Small Business Loans Program. Sales did not meet expectations and within a year the business failed. Only \$35,000 was realized on the collateral and security for the loan. Although the personal net worth of the owners was significant, the total loss they incurred was \$105,000, of which \$80,000 was their original equity contribution. This is significantly less than the \$188,000 loss experienced by the government.

Conclusion: This was a start-up business. The loan had not been subjected to a rigorous credit risk analysis and thorough market research; nor was there a business plan.

Case Study 2 — An Example of a Loan for Which All Debt Obligations Have Been Met

Loan	\$128,000
Industry	business services
Employees	3
Forecast annual sales	\$180,000
Age	new
Assets	\$170,000
Equity	\$35,000
Purpose of loan	to buy the equipment needed to start a new business
Alternative sources of financing	equity contributed by venture capitalist; no other financing available

In early 1996, the owners established a records management business that used automated scanning technology to convert paper records to electronic form. The owners acquired the necessary equipment with capital invested by a venture capitalist and funds loaned through the Small Business Loans Program. The market for the product was assessed in detail and a business plan was prepared. A cash forecast was developed. The owners prepared themselves for the new enterprise through training in using the new equipment and software and in starting a business. The lenders determined that there was a market value for the assets in the event that they would have to be sold, and obtained a collateral mortgage on the equipment and a 25 percent personal guarantee from the owners. At the time of our review, the business was succeeding and had met all its debt obligations.

Conclusion: This was a loan that had been subjected to a rigorous credit risk analysis. The borrower had also developed a sound business plan and conducted thorough market research.

29.66 Industry Canada should ensure that lenders have exercised due care in making loans and have complied with the *Small Business Loans Act* and Regulations.

Department's response: Claims are paid on loans made in accordance with the requirements of the Small Business Loans Act (SBLA) and Regulations. Industry Canada will continue to explore ways and means of amending the legislation and regulations to reinforce the exercise of due care, and provide clearer guidance to lenders under the SBLA.

Related borrowers exceeded maximum loan limit

29.67 The *Small Business Loans Act* limits the amount of lending to a borrower to a maximum of \$250,000. In our sample of loan files, we noted some cases in which a number of individual corporations with substantially common ownership had collectively obtained more than \$250,000 in loans to operate the same business. In one particular case, a group of 23 corporations obtained more than \$4 million in *SBLA* financing. Exhibit 29.7 outlines three cases that came to our attention in which the maximum limit was exceeded.

Exhibit 29.7

Examples of Cases in Which Maximum Loan Limit Was Exceeded

Case 1	A public corporation sold the assets of one of its subsidiaries to its senior management. The sales revenue for the new corporation was projected to be \$4 million for the first year. The new owners needed financing of \$950,000 to buy the assets of the company. They created three related companies in order to obtain most of the financing through three <i>SBLA</i> loans of \$250,000 each. One company purchased the leasehold improvements and furniture and the other two purchased the equipment. These loans were approved in September 1996 and registered in November 1996. The lender also charged \$2,000 for negotiating this financing package.
Case 2	A group of 23 related corporations obtained more than \$4 million of <i>SBLA</i> loans. The group had an equity of \$7 million as of August 1996. The <i>SBLA</i> loans were used to purchase new equipment and to make leasehold improvements. The loan examined in our sample was approved in July 1996 and registered in September 1996. The lender also charged a monthly administrative fee on this loan.
Case 3	A group of retail stores, with loans totalling \$7.8 million from the same lender, used two corporations in order to obtain approximately \$500,000 in <i>SBLA</i> loans. The group had an equity of \$2.5 million. The <i>SBLA</i> loans were used mainly for leasehold improvements. The loan examined in our sample was approved and registered in September 1996.

29.68 Such situations increase the credit risk exposure and, possibly, future losses on the loan guarantee portfolio. Although Industry Canada had indicated, in correspondence with lending institutions, that such loans would not be covered after July 1996, the cases that came to our attention had been registered after that time. Again, without access to the complete loan file for claim review, it could be difficult for Industry Canada to detect these cases.

29.69 Although the *Small Business Loans Act* specifically defines who may borrow under the Program, there are no provisions designed to prevent a group of entities with substantially common ownership from gaining multiple access to loans under the Program. Such rules do exist under the *Income Tax Act*, which has provisions designed to limit access to the low corporate rate of tax for small businesses and to prevent abuse by the creation of a number of related corporations. Clarification of this issue would help to ensure that the Program meets its intent of providing assistance to small businesses within an acceptable level of risk exposure to the government.

29.70 Industry Canada should assess the need to limit access to loans by related entities to the maximum amount allowed and, if the need exists, seek amendment to the *Small Business Loans Act*.

Department's response: A Notice to Lenders was issued in May 1996 to address this specific issue, and further changes will be introduced at the time of the proposed review of the Small Business Loans Act.

Interest paid to lenders can be reduced

29.71 The *Small Business Loans Act* and Regulations require a lender to file a claim on a defaulted loan after having completed all collection procedures. It allows for a period of three years for the lender to file a claim. During the first year, the Department pays the lender a rate of interest equal to the rate at which the loan was issued, usually prime plus three percent. For the second and third years, the rate of interest paid is reduced by half.

29.72 We noted that, on average, lenders submit claims 260 days after the default of a loan. In 1996-97, the Department took an average of 76 days to process claims submitted by lenders. This situation is due in part to the significantly higher volume of claims submitted in the last two years as well as to the number of errors found in the claims.

29.73 The re-engineering of business and management practices and the hiring of additional auditors allowed the Department to significantly increase its claim-processing capability in the last 18 months. The Department advised us that the average time to process a claim is now approximately 30 days.

29.74 The Department was unable to provide us with the amount of interest paid to lenders in 1996-97. We estimate the amount to be at least \$10 million. Industry Canada informed us, however, that since February 1997 the new *SBLA* system captures capital and interest payments separately. The Department indicated that for the period 1 April to 30 September 1997, \$15.6 million of interest was paid to lenders on claims of \$119.3 million.

29.75 We believe that the Department could reduce the interest cost it incurs before and after a claim is received. For instance, it could make provisional payments to lenders after loans have defaulted and settle the balance after a full audit of the claims.

29.76 Industry Canada should take appropriate steps to reduce the interest it is paying on claims submitted by lending institutions.

Department's response: Industry Canada will routinely revisit the conditions tied to the liability of the Minister under the Small Business Loans Act as part of the proposed review of the Act. As noted in the Report, the average processing time for claims has been significantly reduced, and Industry Canada will continue to explore ways of controlling overall costs of the Program.

Accountability to Parliament

29.77 Part III of the Estimates and the Minister's annual report on the Small Business Loans Program have been, to date, the primary instruments used to report to Parliament. To assess the quality of the information provided, we examined Part III of the Estimates for 1995-96 and 1996-97, and the annual reports for the years ended 31 March 1995 and 31 March 1996. The annual report for the year ended 31 March 1997 had not been tabled in Parliament at the completion of our audit. For the same reason, we did not examine the performance report that will be tabled by Industry Canada under the new Expenditure Management System.

Better information on performance is needed

29.78 In Part III of the Estimates, Industry Canada provides information on the number of small businesses using the Program, the number and value of loans issued, the number of loans to be issued, the anticipated total amount of guarantees and the projected job creation. The annual report provides information on access to funds, creation of jobs, and the costs, revenues and outputs of the Program.

29.79 These two documents provide information useful for understanding the context in which the Program operates. However, the activity measurements presented are generally operational statistics, such as the number and value of loans guaranteed, claims paid and loans by financial institutions and by province. We believe that such descriptive information does not enable parliamentarians to assess the extent to which the Program is managed efficiently and is achieving its objectives.

29.80 Information on the Program's results would include the extent to which the Department has achieved its financial objective of full cost recovery and its program objective of increasing the availability of financing to small business. Information on the achievement of the financial objective would need to be on an accrual basis and include revenues, administrative and claims expenditures, and a provision for loan losses. In paragraph 29.34, we stress the need to define clear expected results for the Program. This would enhance the capability to provide better information to parliamentarians on performance.

29.81 **Industry Canada should ensure that parliamentarians are provided with the information necessary to assess the extent to which the Program is managed efficiently and is achieving its objectives.**

Department's response: As noted by the Auditor General, Industry Canada implemented a new information system in 1997 that will allow the Department to supplement, in its 1997-98 report, the information already being provided annually to Parliament. Such information includes at this time lending activity by province, types of lenders and size of business enterprise, as well as claim activity levels, management of program costs and revenues, and the Minister's liability on outstanding loans. In the 1997-98 report to Parliament, Industry Canada will also provide information by industry sector, and report on the efficiency with which the Department has managed program operations in the attainment of program and financial objectives.

Information on jobs created does not reflect actual results

29.82 In its annual report, Industry Canada reports on the number of jobs that borrowers have created under the Program. The 1995-96 annual report, for example, indicated that 81,600 jobs were created during the period, representing 37 jobs per \$1 million of loans guaranteed. Similar numbers were reported in the 1994-95 annual report. We noted that Industry Canada obtains this information through a survey of the loan guarantee registration forms that are prepared by lending institutions and that contain projections of job creation.

29.83 In general, we would have expected more rigor in evaluating the job creation impact of the Program for purposes of reporting to Parliament. For example, the information collected at the time of registration does not take into account "displacement effects" (some loans may result in the displacement of workers in other businesses), which would reduce the net number of jobs created. Some loans actually result in lower direct employment levels — for example, when loans are used to buy labour-saving equipment. The fact that a certain percentage of these loans would have been made without the Program (non-incremental loans) also needs to be considered when computing the number of jobs created. Information on the nature of jobs created could also be useful — for example, whether these jobs are temporary, long-term, low- or high-skill, low-paying or high-paying.

29.84 Industry Canada recently completed a study of the economic effects of the Program. This study suggests much lower employment growth figures than those shown in the last two annual reports. The study also indicates that the Program resulted in about seven jobs per \$1 million of loans guaranteed.

29.85 Industry Canada should report information on job creation that reflects actual results attributable to the Program.

Department's response: Employment growth estimates are provided by individual enterprises at the time of loan application. In addition, Industry Canada regularly commissions research studies into the actual employment impact of the Small Business Loans Act. Industry Canada will continue to commission studies to validate the net impact of the Program, including those of job creation and growth as part of the ongoing program evaluation process.

Conclusion

29.86 The Small Business Loans Program has been financing capital assets since its inception in 1961. The government incurred significant costs under the Program and a decision was made to move toward full cost recovery for loans made after 1 April 1995.

29.87 New lending under the Program will end on 31 March 1998 unless the government decides to renew it. This presents an opportunity to review the Program's contribution to filling current financing gaps and stimulating economic growth and creating jobs. The review would also enable Industry Canada to assess whether the Program meets the needs of small business in a rapidly changing economy.

29.88 We offer in this chapter various suggestions that we believe will be helpful in that review and will contribute to improving the delivery of the Program.

About the Audit

Objective

The objective of our audit was to determine whether Industry Canada has the systems and practices in place to assess whether the Small Business Loans Program is delivered efficiently, in a cost-effective manner and in accordance with the *Small Business Loans Act* and Regulations.

Scope

The audit covered the activities of the Small Business Loans Program, including the related activities of the Small Business Loans Administration Directorate, the Entrepreneurship and Small Business Office in Industry Canada, the regional development entities and lenders. We reviewed the operations of the Program for the period 1 April 1993 to 31 March 1997.

Criteria

The broad audit criteria for this audit were:

- objectives of the Small Business Loans Program should be clearly articulated and the results should be measured, compared and reported;
- the Program should have appropriate internal and management controls to ensure that all revenues are collected and recoveries are maximized in conformity with good business practice;
- the Program should be administered efficiently and cost effectively; and
- Parliament should be provided with relevant, reliable and timely information on the performance of the Program.

Approach

We interviewed officials of Industry Canada and of federal regional development entities as well as some Small Business Loans Program lenders. We also interviewed a number of loan officers and examined a statistical sample of lenders' files of registered loans and claims. In addition, we examined relevant documents including departmental and other studies, parliamentary debates, Part IIIs of Estimates and Small Business Loans Program annual reports. We also held a stakeholders' meeting that included representatives of lenders and borrowers, as well as experts in the subject matter, in order to understand their needs for access to financing.

Audit Team

Christian Asselin
Louise Bertrand
Luc Demers
Bryan De Pape
Denis Robert

For information please contact Harry A. Ruthnum, the responsible auditor.

Chapter 30

Office of the Superintendent of Financial Institutions — Insurance and Pensions

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Office of the Superintendent of Financial Institutions — Insurance and Pensions

Assistant Auditor General: Ron Thompson

Responsible Auditor: Crystal Pace

Main Points

30.1 Since 1987, when the Office of the Superintendent of Financial Institutions (OSFI) was established, the financial services industry has become much more integrated. The legislative framework has developed from a highly prescriptive system to one relying heavily on good corporate governance to ensure that depositors, policyholders and pension plan members are protected, without unduly restricting the competitive ability of Canadian financial institutions. Legislators have recognized that although regulation and supervision can reduce the risk that financial institutions will fail, some may fail nonetheless. OSFI has made significant progress in developing regulatory tools to meet its objectives, in response to the changing nature of the industry and the legislative framework. Although OSFI meets the needs of today's environment, it nevertheless needs to address important gaps that could affect its ability to meet its objectives in the future.

30.2 A key to success for OSFI is having the right people with the right competencies and using them effectively. OSFI has the basic human resource management systems in place and operating, and is moving forward on a variety of fronts. However, at this point it does not have some important information that it needs to estimate the degree to which activities planned or under way will help it achieve its objectives. It needs to have a more strategic approach to human resource management and a more rigorous analysis of issues to ensure that current and planned activities will help it meet its goals and objectives.

30.3 Overall, we found that OSFI is highly regarded by the insurance industry and by provincial and foreign regulators. It has developed some key aspects of its risk assessment and risk management framework -- standards for sound business and financial practices, and guides to intervention. However, they are not yet complete. We identified gaps in the implementation of the framework that could prevent OSFI from meeting its objectives in the future. For example, it needs to apply its risk ratings more rigorously; focus its life insurance examinations on key risks; and improve the integration of its analysts, examiners and actuaries. In addition, communication and co-ordination with regulated entities and other regulators need to be improved.

30.4 The supervision of pension plans at the federal level is in a state of transition. OSFI has recognized the need for a new regulatory framework that includes a new mandate focussed on protecting plan members, greater powers to intervene when plans are in difficulty, and formalized procedures for risk assessment. OSFI plans to establish a *Guide to Intervention* and *Standards for Sound Governance and Financial Practices* for pension plans.

Introduction

Evolution of the Office of the Superintendent of Financial Institutions

30.5 Putting it all under one roof. OSFI was first established in 1987 by the amalgamation of the Department of Insurance and the Office of the Inspector General of Banks. This put the federal supervision of banking, insurance and pensions under one authority. However, OSFI was still organized internally along business sector lines, with little commonality among them in the regulatory framework or the systems for assessing risk. There were still clear distinctions among the financial industry's "four pillars" — banks, trust companies, insurance companies and securities firms.

30.6 Changes to investment and ownership rules. In 1992, important legislative changes were introduced to reflect the changing nature of the financial services industry. Restrictive investment criteria were replaced by "prudent person" criteria. Restrictions on cross-ownership among banks, trusts and securities firms were eased. These changes made it imperative that the financial regulatory framework provide a "level playing field" for the three pillars regulated by OSFI — banks, trust companies and insurance companies. The change from restrictive investment criteria meant that OSFI no longer needed to verify that investments met the detailed requirements of the legislation. Instead, it began to change its focus from compliance to issues of solvency and good corporate governance to ensure that regulated entities were managed prudently.

30.7 Introduction of "Standards" helped implement the new legislative framework. In 1993, Canada Deposit Insurance Corporation (CDIC) adopted as regulations the "Standards for Sound Business and Financial Practices" for deposit-taking institutions that are members of CDIC. These Standards, while further defining good corporate governance, helped OSFI and CDIC use sections of the legislation that permitted sanctions for poor practices. This allowed them to respond earlier when financial institutions deteriorated. Similar standards for life insurance companies were developed jointly by the industry and OSFI and were adopted in January 1997. Once those have been implemented, OSFI and the Insurance Bureau of Canada (IBC) will develop standards for property and casualty companies. OSFI is developing standards for pension plans as well.

30.8 Guides to intervention helped to develop the framework. In February 1995, *the Guide to Intervention for Federal Deposit-taking Institutions* and the *Supervisory Guide Applicable to Federally Regulated Insurance Companies* were introduced to promote awareness and enhance the transparency of the system of intervention in federally regulated financial institutions. The guides outlined the steps that OSFI could be expected to take if the financial condition of an institution deteriorated. They outlined the criteria for determining the degree of intervention required, ranging from "stage 0", for institutions of no concern, to "stage 4" for institutions on the verge of failure. The disclosure of this process and of the actions that are considered at each of the stages of intervention has improved the understanding of OSFI's supervisory role. The 1995 guide for deposit-taking institutions also covered CDIC's role in the intervention process. In January 1997, the actions of CompCorp, the compensation fund for policyholders of failed life insurance companies, were incorporated into the guide for life insurance companies. OSFI is developing a similar guide for pension plans.

30.9 OSFI reorganized to help meet the needs. In August 1995, OSFI reorganized in response to the increasing breakdown in the distinctions among the four financial institution pillars and to the creation of more financial conglomerates. Its supervisory work for all federally regulated financial institutions and pension plans was centralized in a new Operations Sector. Another objective of the reorganization was to establish a more consistent approach to policy development for financial institutions, regardless of type. The policy-making divisions of each OSFI financial services industry group were merged to create a new Policy Sector, which assumed responsibility for all policy development in OSFI. The new structure improved consistency in decision making with respect to financial institutions and enhanced the supervision of financial services conglomerates.

30.10 New legislative mandate helped. The basis for efficient and effective operations is a good accountability arrangement. This is particularly important for OSFI because its operations are funded primarily by the entities it regulates. In 1996, legislation was passed that provided a clear mandate for OSFI's regulation of deposit-taking institutions and insurance companies. The legislation set out a number of objectives specifying how OSFI should achieve its purpose of contributing to public confidence in the Canadian financial system. The mandate states that in carrying out its objectives, OSFI "shall strive to protect the rights and interests of depositors, policyholders and creditors having due regard to the need for financial institutions to compete effectively and take reasonable risks."

30.11 OSFI proposed a similar mandate for pension plans in its July 1996 White Paper. In addition to clearer authority, the White Paper proposed stronger regulatory and supervisory powers for OSFI and resulted in the tabling of Bill C-85, which died on the Order Paper when an election was called in April 1997.

30.12 Strategic objectives established. OSFI established a new mission statement and, in 1996, strategic objectives, as first steps in implementing its new mandate (Exhibit 30.1). It also reviewed its legislated responsibilities, and began a process to transfer to other organizations some of the responsibilities not directly related to its mandate. (For more information see OSFI's Annual Report and Part III Estimates, on the Internet site <http://www.osfi-bsif.gc.ca>.)

Exhibit 30.1

(This exhibit is not available, see the Report)

30.13 Good progress in developing performance measures. OSFI is now in the process of developing key performance measures to compare results achieved with expected results for each of its strategic objectives. These measures will include indicators of change in industry-wide risk, the relative cost to industry of OSFI's regulatory requirements, and service standards. OSFI told us it intends to use the resulting information internally to manage its performance, and plans to publish some of the indicators in its 1998-99 Annual Report. In our view, OSFI is at the forefront in developing performance measures for a regulatory regime.

30.14 Linking goals to activities is a challenge. Completing its accountability framework will be the next challenge for OSFI. It needs to complete recent initiatives aimed at describing more clearly how its activities contribute to its strategic objectives and at what cost, and needs to use this information to allocate resources more efficiently and effectively (Exhibits 30.2 and 30.3).

Exhibit 30.2

Historical Comparison of OSFI Costs 1988-1996

	31 March 1988 (\$ millions)	31 March 1996 (\$ millions)
Operations Sector		
Life Insurance Division	2.7	5.4
P&C Insurance Division	2.3	4.1
Pension Plans Division	1.2	2.4
Deposit-taking Institutions Division	<u>5.9</u>	<u>8.0</u>
Subtotal	12.1	19.9
Policy Sector	1.4	5.1
Corporate Services and Superintendent's Office	6.7	11.1
Chief Actuary	<u>1.6</u>	<u>2.2</u>
OSFI total	<u>21.8</u>	<u>38.3</u>

Source: OSFI

Exhibit 30.3

Use of OSFI Resources

Full-time equivalents, by division

	31 March 1988	31 March 1996
Operations Sector		
Life Insurance Division	46	63
P&C Insurance Division	37	50
Pension Plans Division	28	29
Deposit-taking Institutions Division	<u>89</u>	<u>86</u>
Subtotal	200	228
Policy Sector	26	59
Corporate Services and Superintendent's Office	83	82
Chief Actuary	<u>20</u>	<u>20</u>
OSFI total	<u>329</u>	<u>389</u>

Source: OSFI

Changing environment will mean new ways of regulating

30.15 Technology impacts are profound. The impacts of technology present a large future risk for all regulators. OSFI has begun to study the challenges it faces as many unregulated entities begin to offer services traditionally offered only by regulated entities, and as regulated entities adopt new ways of doing business. OSFI will have to deal with outsourcing of operations, new forms of business such as insurance sold over the Internet and, potentially, the entry of insurance companies into the Canadian payments system for cheques and other financial instruments.

30.16 New complexities add risk. It is increasingly difficult to separate the business lines of insurance, investment and banking. To illustrate, the life insurance industry reported that insurers made payments of more than \$30 billion to their Canadian customers last year, but less than 10 percent of this was in death benefits. About 60 percent of the balance was from wealth management and wealth accumulation products, with the other 40 percent split between life protection and health and disability products.

30.17 New products and increased competition were cited by industry people we interviewed as areas of high risk. In the past, products were fairly constant from one year to the next. Now there are new products on the market almost every day. The new products may compete with products in other sectors — annuities may substitute for guaranteed investment certificates, for example. The entities developing the products may not price them appropriately. Or they may risk promising too much to the consumer, resulting in huge liabilities from lawsuits like those seen recently over “vanishing premiums”. While industry rating agencies found that ratings of Canadian life and health insurers are high by international standards, they warned in May 1997 that a tough competitive environment may lead to downgrades in the ratings.

30.18 Restrictions on free trade continue to decrease. In July 1995, Canada signed an interim deal on trade in financial services under the General Agreement on Trade Services (GATS) of the World Trade Organization (WTO). Under this agreement, Canada retained certain limitations that could be changed when the interim agreement expires at the end of 1997. Increased trade in financial services provides an opportunity to Canadian companies to sell more products abroad. It also creates risk through increased competition and the difficulty of

regulating the Canadian operations of companies based outside Canada. Regulating large, complex, international conglomerates or large, complex pension plans will pose challenges to regulators in the future.

30.19 Need for increased co-operation and speed. These changes all point to the need for increased co-operation with other regulators, both provincial and foreign, and the need for increased ability to respond quickly to new developments.

30.20 The former chairman of the U.S. Federal Deposit Insurance Corporation (FDIC), in a January 1997 speech, recognized the need to be proactive and to plan well. “In containing the most recent banking crisis...two lessons [have been] learned...first...monitor and assess risks in the industry in a way that anticipates future problems...second...a more systematic approach to managing ourselves to assure continued success in the future...planning, organizing, directing and controlling what we do to meet our objectives...All other functions of management rest on planning.”

30.21 Many regulators, including OSFI, have recognized that one way to improve regulatory response time is to establish incentives that enhance the industry’s efficiency, such as linking regulatory charges to the level of service required, increasing public disclosure of entity information, and increasing the transparency of regulatory expectations and requirements.

30.22 For example, the U.S. Federal Reserve (the Fed) has streamlined the process for approving new activities, using disclosure as a regulatory tool. Well-managed and well-capitalized bank holding companies may now start certain new activities without prior approval. However, they must publish their application in order to allow for community input, and notify the Fed within 10 days. The Fed determines whether the company qualifies as “well managed and well capitalized”.

30.23 Recognizing the need for better co-operation, in December 1996 OSFI established the position of Special Advisor to the Deputy Superintendent of Policy. The Special Advisor is responsible for developing plans to improve relations with other regulators.

30.24 OSFI will need to continue evolving in response to increasingly rapid changes in the industries it regulates.

Focus of our audit

30.25 This audit was intended to determine whether the Office of the Superintendent of Financial Institutions (OSFI), with respect to its insurance and pensions operations:

- has a clear mandate, roles and responsibilities as well as adequate performance measures, internal quality controls and reporting to meet its accountability requirements;
- has adequate and efficient systems, procedures and capabilities to safeguard policyholders and plan members from undue loss;
- contributes to public confidence by anticipating future challenges and adjusting its activities to meet them.

30.26 Further details on our objectives, scope and criteria can be found at the end of the chapter, in **About the Audit**.

Follow-up of previous audit work

30.27 Our last audit of insurance and pensions regulation was described in our 1986 Report, Chapter 12, on the Department of Insurance. Of the 25 recommendations in that chapter, OSFI has implemented or made significant progress with 22. Outstanding issues related to integration of human resource planning with operational planning, and to better co-ordination and integration of the work of examinations and analysis staff, are discussed later in this chapter.

30.28 In 1995 we reported on OSFI's regulatory activities with respect to deposit-taking institutions. In accordance with our normal practice, we will conduct a follow-up audit on those recommendations in the future.

Observations and Recommendations

Human Resource Management

30.29 OSFI is an organization of fewer than 400 people (Exhibit 30.3) located in five urban centres — Ottawa, Montreal, Toronto, Winnipeg and Vancouver — with different operational requirements and different external labour markets. Good human resource management and its integration with strategic business objectives are essential to achieving the organization's mission and strategic objectives. We reviewed OSFI's human resource management as it applies to insurance and pensions operations.

OSFI has identified some key human resource management issues

30.30 **Having the right staff is critical to OSFI's success.** Several aspects of human resource management are viewed by OSFI as particularly important to the organization. For example, the ability to attract highly qualified staff could be expected to impact on the organization's stated objectives in the areas of "safeguarding from undue loss", "quality" and "public confidence". Retaining valued staff also has implications for these objectives (in terms of developed expertise and continuity) as well as for cost effectiveness. Finally, staff competencies — the capacity of staff to understand the institutions they regulate and to be up-to-date on industry developments — are critical to OSFI's achieving its strategic objectives and becoming a learning organization.

30.31 OSFI's framework for human resource management — the related philosophy, policies and systems, and the accountability and control framework — has been in revision for the past two years to make it more responsive to OSFI's changing needs. For example, clearly stated values and new performance assessment practices have been adopted, a new job evaluation and classification plan is being developed, and an employee survey is being carried out.

30.32 **OSFI has identified a number of issues.** OSFI has identified certain human resource management issues that need to be addressed. In its view, three key areas in particular — staff recruitment, retention and learning — need significant strengthening.

30.33 OSFI recognizes that its difficulty in obtaining qualified human resources and appropriate skills is related to its human resource management framework and to the effectiveness of systems for staffing, compensation, career management, and professional development. These issues and supporting systems are interrelated — action in one area can impact on another area.

30.34 **Will corrective actions under way resolve the issues?** A significant number of initiatives are under way to address these issues. For example, OSFI has undertaken a training needs analysis and published a new learning

guide; is identifying core competencies and developing a career management structure; and is reviewing its separate employer status to determine if the flexibility currently provided is sufficient or if other avenues should be explored. Having taken these first important steps, in our view it is now time for OSFI to “pause and reflect” as important decisions on human resource management are considered and made. In doing so, OSFI needs to document its analyses of relevant issues as clearly and completely as possible. This would serve two important purposes. First, it would help senior management review and challenge recommended courses of action and their alternatives. This would help to ensure that decisions are timely, that activities are in the right sequence and that OSFI management has full knowledge of what will be gained and what will be given up. Second, it would help senior management demonstrate, to other stakeholders such as regulated industries and government organizations whose support may be required, that proposed changes are necessary and appropriate.

Need for improved tie-in to OSFI’s vision for the future

30.35 The need for a longer-term and more strategic approach to human resource planning. Because of the importance of OSFI’s regulatory responsibilities and the essential nature of the services it provides, it is essential to ensure that qualified staff are available in appropriate numbers. The skills required by the organization need to be continuously assessed against available resources, and requirements determined through objective research. Depending on its future regulatory strategy, OSFI could require staff in significantly different numbers with different sets of skills. Furthermore, because many of the issues facing OSFI will not be resolved in the short term, a longer-term and clearly articulated approach needs to be developed.

30.36 The documents we reviewed showed activities planned for the current year only. Linkages were not clearly articulated between activities proposed or under way and OSFI’s vision of its human resource management in the future, given the changes occurring in its environment and their impact on its regulatory strategy. Furthermore, OSFI needs to review its allocation of the priority of various projects to ensure that they are well integrated and conducted in the optimum order while taking into account operational priorities, such as staffing vacant positions. Seven human resource projects we reviewed had an A priority — the highest — all with completion dates of April 1998 or earlier. Two had a B priority, but also had completion dates of April 1998 or earlier. In our view, it will be difficult for OSFI to successfully complete all of these projects simultaneously, especially as some are interrelated.

30.37 OSFI has taken some steps in the right direction. OSFI is devoting significant efforts to improving its planning and the integration of the human resource management function with its Strategic and Business Plans. It believes that, once completed, these steps will provide a longer-term, more strategic approach that will respond to its regulatory strategy in the future.

30.38 OSFI should ensure that its human resource management activities are clearly linked to its vision of the future. In particular, OSFI should ensure that:

- **the development of human resource policies and systems is guided by a clear definition of the way it expects human resources to be managed in the longer term; and**
- **priorities allocated to human resource projects optimize the sequence and integration of the various projects while taking into account operational priorities such as staffing vacant positions.**

Some human resource issues require more thorough, documented analysis

30.39 Further developing the human resource framework: considering all options. Of particular importance is the need for OSFI to continue to develop its human resource framework and systems to provide a proper balance among possibly conflicting objectives, such as flexibility, service quality, maintaining independent, professional working relations with the financial institutions it regulates and providing employees with rewarding experiences

and careers. OSFI already has significant authority to deal with what it considers its most problematic human resource concerns, and has recently begun to make use of that authority. For example, in 1996 OSFI began a classification study with the intentions of making more use of its authority to evaluate or classify positions and developing a compensation policy that would enhance the recruitment and retention of staff. Because some of the options it is contemplating could require changes in its legislation, OSFI needs to ensure that decisions are supported by documented analyses of both the costs and benefits of the various alternatives available.

30.40 Analysis of recruiting efforts. In a number of documents we reviewed, OSFI stated that chronic vacancies were responsible for delays in examinations and in issue analysis. Vacancy rates were especially high in examiner and support staff positions in Toronto. For example, at the time of our audit, 12 of the 20 life insurance examiner positions were vacant and managerial staff were performing examiners' work. In addition, OSFI reported a significant number of term or acting appointments. To the extent that a substantial number of positions are not filled, OSFI's work and its ability to meet its objectives could be seriously affected. In addition, the use of higher-level employees to perform lower-level duties impacts on staff utilization rates, motivation, and cost effectiveness. OSFI reported that non-competitive compensation was one of the major reasons for the loss of valuable employees and that non-competitive salaries and limitations imposed by the *Public Service Employment Act* were major reasons for difficulties in recruiting qualified staff.

30.41 We found that, while OSFI produces monthly establishment reports showing vacancies and staff movements, no summary report was available on the length of time it has taken to fill various positions, the reasons for any delays, and the impact this had on OSFI's operations. In addition, no detailed analysis of turnover was readily available.

30.42 In the sample of files we reviewed, we found that competitions for professional staff had taken some time to run their course. However, difficulties in identifying suitable candidates and filling vacant positions appeared to be attributable less to legislative requirements than to OSFI's internal processes and the fact it had not yet taken full advantage of the considerable authority available to it. We also found that despite concerns about salary levels and although it has referred to broader surveys of the financial industry, OSFI has not done a salary survey since 1989-90 in accordance with its decision to comply with government policy on salary freezes in recent years. OSFI needs more concrete data to demonstrate that remuneration levels have had a negative impact on its ability to achieve its staffing objectives and that it needs special flexibility in salary levels.

30.43 Options that could help. We found that OSFI has not taken advantage of some options available to it that could assist in expanding the pool of potential candidates and achieving its staffing objectives. These include, among others:

- enhancing its visibility as an employer of choice, by identifying and communicating, in the appropriate media, unique characteristics that OSFI possesses and that are liable to interest potential candidates, such as the opportunity to acquire an overview and understanding of financial institutions as a whole; and
- the development of an appropriate recruitment strategy — related to its new mission, strategic objectives and goals — that could then serve as a basis not only for recruitment but also for an approach to professional development. This could include decisions on such matters as whether to develop and maintain in-house expertise or hire experts on contract instead; recruiting recent university graduates or co-op students for a specified period of time; and recruiting retired people with experience in financial institutions.

30.44 Analysis of retention efforts. Management has expressed concerns about losing high-potential employees relatively soon after hiring them. However, OSFI does not produce or analyze profile reports on employees. Such profiles could include length of service in a job, in the sector, and in OSFI, as well as information on competencies, performance and potential. In our view, in the absence of rigorous, documented analyses, it will be difficult for OSFI to demonstrate persuasively whether the loss of competencies or of high-potential employees is a systemic problem or is related only to a few cases, whether pay levels are the causal factor, or whether retention problems

occur in specific locations only. The problem may be complex, and may be affected by such factors as the size of the organization, opportunities for promotion or job rotation, and other pressures.

30.45 OSFI should ensure that:

- **changes it makes in its human resource management framework or in recruitment and retention strategies are based on rigorous, documented analysis; and**
- **its analyses consider the costs and benefits of alternative courses of action in light of its mission, strategic objectives and vision for the management of human resources in the future.**

Importance of staff skills and professional development

30.46 Skills development essential. OSFI recognizes that learning activities are an essential business investment of time and money and that they can contribute to the accomplishment of strategic objectives as well as to the personal goals of employees. It also recognizes that the work environment must support a culture of continuous learning — one that encourages among staff a shared responsibility for learning, and provides employees with equitable access to learning activities related to their job requirements and career aspirations.

30.47 Initiatives to address concerns. Nevertheless, OSFI officials expressed concerns about the need to have the highly qualified, up-to-date staff necessary to keep pace with the rapid changes in the industry. In part this was identified as a recruitment issue, but it is also related to OSFI's ability to provide a learning environment and training opportunities. A number of initiatives have been undertaken to address this. For example, OSFI has identified continuous learning as an important part of its strategic management; allocated three percent of its salary budget for professional development and training; and developed a learning guide and undertaken a training needs analysis of individuals. It has also sent employees on training programs in such areas as change management, has established a self-learning centre, and is designing a career management structure. OSFI has informed us that it is beginning to obtain feedback on individual courses and on the impacts of on-the-job training.

30.48 Technical training needs more emphasis. We found that additional work needs to be undertaken to arrive at a better balance between technical training needs identified from a strategic or corporate perspective and training needs identified through employee feedback or within divisions.

30.49 There is also a need to ensure better linkage between identified training needs and actual training delivered or undertaken. At the conclusion of our audit, it was unclear on what basis training was allocated to staff. OSFI needs to get a clearer picture of all the types of training and learning opportunities provided to its employees. It recognizes that it can maximize the return on its investment in learning through better tracking of training initiatives, and is starting to monitor initiatives and projects in that light.

30.50 OSFI should develop mechanisms to ensure that the organization's training and learning needs are met and controls are in place that will maximize the return on its investment in learning.

Insurance Supervision

30.51 Life Insurance Division. The Life Insurance Division has overall responsibility for the supervision of federally registered life insurance companies, branches of foreign insurance companies, fraternal benefit societies and branches of foreign fraternal benefit societies. As of 31 December 1996, as Exhibit 30.4 shows, there were 128 federally registered life insurance companies (57 federally incorporated and 71 foreign companies) and 28 fraternal

benefit societies (13 federally incorporated and 15 foreign societies). The Division includes the following sections: Operations Analysis, Corporate Analysis, Actuarial Analysis, Examinations, and Securities Administration.

Exhibit 30.4

Life Insurance Companies and Fraternal Benefit Societies 1996

	Number of Companies	Assets Supervised by OSFI			Assets outside Canada Not Supervised by OSFI (\$ billions)
		Assets in Canada (\$ billions)	Assets out of Canada (\$ billions)	Total assets supervised by OSFI (\$ billions)	
Canadian companies	70	120.7	111.1	231.8	119.7
Foreign companies ¹	86	34.8	0	34.8	1544.6 ²

Source: OSFI

Notes:

¹ Foreign companies operate in Canada as branches or subsidiaries of the parent company.

² As reported to OSFI by the companies

30.52 OSFI is the court-appointed liquidator for the winding-up of most of the federally incorporated insurance companies in liquidation. OSFI told us that liquidations are managed by professional liquidators selected through a competitive process, in consultation with the industry and policyholder protection fund managers. It also told us that it carries out validation work to control and supervise the liquidations. As noted in the Scope section of **About the Audit**, we did not audit the liquidations operations of OSFI.

30.53 Property and Casualty Division. The Property and Casualty Insurance Division (P&C) has overall responsibility for the supervision of federally registered property and casualty insurance companies and branches of foreign insurance companies. As of 31 December 1996, there were 97 companies incorporated in Canada and 126 foreign companies operating on a branch basis (Exhibit 30.5).

Exhibit 30.5

(This exhibit is not available, see the Report)

30.54 The Property and Casualty Insurance Division includes the following sections: Operations Analysis, Corporate Analysis, Examinations, Liquidations (for both life insurance and property and casualty insurance companies) and Actuarial Affairs. In this Division, the actuaries also perform the actuarial examination function.

30.55 OSFI is a leading regulator. Insurance companies we interviewed were unanimous in their view that OSFI's regulatory practices are further advanced than those of other provincial, federal or national regulators they deal with. Other regulators throughout the world visit OSFI frequently to study the Canadian regulatory framework. Many other regulators are only now adopting the integrated regulatory framework, described in the Introduction of this chapter, that OSFI has had in place for the past few years. For example, Ontario announced in the spring of 1997 that it intends to amalgamate its Insurance and Pensions regulatory bodies.

A need to implement the risk assessment and risk management framework

30.56 OSFI has made progress in implementing the guide to intervention. OSFI introduced a new rating system for insurance companies in 1995-96 that follows its guide to intervention for insurance companies (*Supervisory Guide Applicable to Federally Regulated Insurance Companies*). The system assigns a “stage” rating to a company on a scale of 0 to 4: 0 indicates no problem; 1 is an early warning of some deficiencies; 2 indicates risk to financial viability or solvency; 3 notes that future viability is in serious doubt; and 4 means the company is not viable or insolvency is imminent. The guide sets out the criteria for rating a company at each stage as well as the actions expected of OSFI and company management. For the life insurance industry, the guide also includes the actions expected of CompCorp, the compensation fund that protects policyholders if a life insurance company fails. OSFI has improved the transparency of the supervisory framework by distributing the guide to all regulated insurance companies. After their review of annual filings, OSFI analysts rate the companies and then revisit the ratings quarterly and report the results to OSFI senior management.

30.57 In our review of files, we found that OSFI’s life insurance analysts generally do a thorough analysis of company filings, appointed actuaries’ reports and DCATs (Dynamic Capital Adequacy Test — a key test of the sensitivity of a company’s capital and earnings to economic, business and actuarial changes). They analyze early-warning test results to identify questions and risks that require attention, and prepare pre-examination reports for examiners, reports to OSFI senior management and monthly reports to the Minister on companies where there is a risk to financial viability or solvency (rated at stage 2 or higher).

30.58 The Property and Casualty (P&C) division has made particularly good progress in providing guidance to staff, with the practical application of the *Guide to Intervention for Insurance Companies*; it could serve as a model for other OSFI divisions. The P&C Division analysts use an automated process that rates the companies using a point system based on ratios. The analyst reviews the results provided by the rating system and applies his or her judgment to determine whether or not to modify the suggested ratings.

30.59 Gaps could prevent OSFI from meeting its objectives. Although OSFI is a leader in developing regulatory practices, we found gaps in the implementation of its risk assessment and risk management framework that could prevent it from meeting its objectives in the future.

30.60 Difficulties with ratings. While most of the P&C automated system has worked well, we found one area that could be improved. The analyst is to provide a rationale if the rating suggested by the automated system is modified. We expected that there would be clear criteria to assist staff in making this judgment. However, we noted that the analysts’ files did not always have a clear rationale for modifying the company ratings, or for the evaluation of qualitative elements such as the rating of management.

30.61 We noted in minutes of its advisory committee meetings that OSFI has been hesitant to inform a company when it moves to stage 3 because it believes moving a company to stage 3 could potentially result in public disclosure by the company, with significant impacts on public confidence and the viability of the company. It is concerned that public disclosure will undermine the effectiveness and efficiency of its work. However, OSFI has advised us that it now informs a company whenever its rating moves up or down a stage, thereby improving the clarity of the message given to company management.

30.62 OSFI may be reluctant to rate companies at a level higher than stage 2. OSFI managers have noted that the rating is very much a question of judgment. However, in three of the cases we reviewed it was questionable whether, in not rating companies at the stage 3 level more promptly, OSFI had followed its guide to intervention. Any reluctance can reduce the effectiveness of OSFI’s early warning system: companies rated at a lower stage than is warranted may not receive adequate attention.

30.63 Examinations contribute to industry improvements. OSFI examination staff in Toronto, Vancouver, Winnipeg and Montreal conduct well-planned, systematic, thorough examinations of companies. Companies are selected for examination based on factors such as new incorporation, risk rating and size. During 1996, 50 percent of life insurance companies and 51 percent of P&C companies carrying on active insurance operations underwent an on-site examination. Examiners consider information from a variety of sources such as analysts' reports, prior years' management reports and files, external auditors' reports and files, minutes of boards of directors, press clippings, and rating agency reviews. They use some specialists such as actuaries, credit consultants or treasury specialists, as appropriate. At the conclusion of the examination they discuss their findings with company management, report to OSFI senior management and to the company's audit committee, and follow up on responses to their recommendations. Companies we interviewed agreed that the process generally contributes to continuous improvement in industry management and compliance with the *Insurance Company Act* and regulations.

30.64 Life insurance examinations need to be better focussed. We found that examinations of property and casualty insurance companies are well focussed on the key risk areas. Examination plans, reports and files provide clear support and rationales for the work done.

30.65 However, in about half the life insurance cases we reviewed, it was not clear that OSFI had focussed its examination on significant risks. While there were no apparent gaps in the examination procedures, examiners may be doing more work than necessary in low-risk areas and consequently less in-depth work in higher-risk areas. We observed that examination procedures could be better tailored to the particular risks in each company. As well, files do not adequately document how the previous year's examination findings were taken into account in order to reduce work or focus on key areas.

30.66 We noted that a limited amount of time is spent looking at the future business viability of companies, while much of the life insurance examination resources are spent on reviewing mortgages. We question the need for such a detailed review, since OSFI told us that most life insurance companies now have adequate systems to monitor their mortgages. We noted that OSFI reviews strategic plans, but there is little evidence of links between that review and the review of a company's report on Dynamic Capital Adequacy Testing (DCAT). In our review of files, we found little evidence of discussions with senior company management about the impact of the strategic plan and DCAT on the future of the company. Life insurance company managers we interviewed suggested that discussions with OSFI could help improve the examiners' focus on future viability as well as on key risk areas.

30.67 Although OSFI is placing reliance on the internal and external auditors, life insurance examination files do not contain a rationale linking specific work performed by the auditors to OSFI's examination procedures. Without this link, it is not always clear what work OSFI is relying on and therefore it is difficult to determine whether and how its examination procedures could be reduced or eliminated.

30.68 Focussing its examination efforts is particularly important given the significant constraints on OSFI's resources. As we have noted, at the time of our audit, 12 of the 20 life insurance examiner positions in Toronto were vacant.

30.69 Use of experts. OSFI relies on the work of the external auditors to assess the adequacy of the management information systems in the life insurance companies it examines. However, we found little documentation in the examination files to support OSFI's assessment of the readiness of many companies' systems for the impact of the Year 2000 systems changeover. (Interest charges, premium billings, dividend credits, etc. could be miscalculated if computer routines were to interpret year 2000 as preceding year 1999 by 99 years rather than following it by one year.)

30.70 OSFI has recognized the need for more expertise in the assessment of information technology. A recent OSFI study noted that in the future, examiners may be required to possess at least enough knowledge of the various systems and applications in use to judge their general adequacy and differentiate between those that minimize risk and those that create their own risk. Examiners may also have to exercise judgment in determining which potential

problems they can address themselves, which ones require some additional expertise, and which require a great deal of additional expertise. However, we saw little evidence that OSFI had considered these requirements. For example, there was no mention of them in operating plans. Industry representatives whom we interviewed agreed that OSFI could make better use of contracts to obtain expertise in this area as well as in other areas, such as the evaluation of actuarial reports.

30.71 In order to give credence to its guide to intervention for insurance companies, OSFI should develop a more rigorous system of determining a company's rating — one that consistently includes the views of analysts, examiners and actuaries. If the impact of public disclosure is a real concern, OSFI should pursue changes to the legislation or regulations to prevent such disclosure.

30.72 OSFI should continue to work with the property and casualty insurance industry to define standards of sound business practices for the industry.

30.73 To enhance its efficiency, OSFI should better focus its examinations of life insurance companies on the key risk areas and on the assessment of the future business viability of the company, and improve its use of consultants with expertise in areas such as information technology and actuarial reports.

Avoiding overregulation

30.74 Approval process is slow despite OSFI's quick response. Industry representatives we interviewed told us that OSFI's corporate analysts are well respected for responding promptly to company requests for approvals of acquisitions, asset transfers, reinsurance or other matters requiring OSFI's or the Minister's approval. However, in our review of files we found that the myriad approval requirements make the whole process immensely time-consuming, however promptly the staff act. Some other regulators have recently moved to after-the-fact review and approval of some transactions for companies that are adequately capitalized and pose no risk to the system.

30.75 Capital requirements for life insurance companies are complex. OSFI has established well-defined, risk-based capital requirement standards and it monitors compliance with them to ensure the protection of policyholders through adequacy of capital. The standard for life insurance companies is called the Minimum Continuing Capital and Surplus Requirement (MCCSR). MCCSR is a ratio calculated by the company in accordance with OSFI's instructions. Determining the MCCSR is a complex process that attempts to take into account most aspects of the company's operations. OSFI's guideline to the industry setting out these instructions has changed frequently since its introduction in August 1992. Company managers we interviewed had difficulties with the MCCSR, including the detailed, lengthy review process, lack of a standing committee to ensure ongoing consultation, inconsistencies with other national regulators and ambiguous wording subject to misinterpretation. OSFI intends to avoid any further changes until it has monitored the impact of the current MCCSR guidelines.

30.76 OSFI and the Department of Finance should closely examine the compliance requirements and consider alternative methods to ensure that any negative impact on companies is minimized.

Integration of work of actuaries, analysts and examiners

30.77 OSFI's Property and Casualty actuaries' work is well organized. OSFI's P&C actuaries perform systematic, detailed reviews of claims reserves and unearned premium reserves. They use their software systems and company data to calculate information for comparison with the company actuary's calculation. Subsequently, they judge whether any differences are material and need to be discussed. For priority companies, the reviews follow the examination schedule every year; the objective is to review other companies every two years. However, OSFI has not yet reached that objective. It has told us that of 238 companies, the P&C Actuarial Affairs Section reviews 60 to 70 a year.

30.78 OSFI's life insurance actuarial resources are limited. Our examination of OSFI life insurance actuaries' work in Ottawa and Toronto found that they do a competent, professional job of reviewing the work of companies' appointed actuaries (actuaries appointed by the company who have statutory duties under the *Insurance Companies Act*). However, the actuarial staff resources in Ottawa are very limited. They include only one manager, two fully qualified actuaries, one analyst and support staff. The Actuarial Examination Section has been without a Director for the past three years, since 1994-95. There is no actuarial manager for the Toronto actuaries; all four actuarial examiners report to the Acting Director, Examinations. Actuarial staff in Toronto are involved in many aspects of the examination function beyond a review of the appointed actuaries' work. OSFI recognizes that it does not have the resources to do in-depth analyses of all actuarial reports.

30.79 Role not clear. The role of OSFI actuaries and the use made of their work are not clear. OSFI life insurance actuaries in Ottawa set up their own rating system for company reserves, independent of the rating system used by OSFI analysts. The actuaries' system rates the reserves on a scale of 0 to 3 rather than 0 to 4.

30.80 Actuarial work not integrated. In our review of both life and P&C examiners' and analysts' files, we found little evidence of attention to the work of OSFI actuaries. Examiners and analysts concentrate on other matters, or feel quite confident about reviewing the work of the appointed actuary themselves. We also noted that the actuaries' files indicated little exchange of information with the examiners and analysts. During 1996-97, the life insurance actuaries in Ottawa reviewed approximately 100 actuarial and DCAT reports and those in Toronto reviewed approximately 30 such reports. In our review of OSFI's files, we noted that the actuaries send a copy of their reports to the analysts. However, we found little evidence that analysts consulted with the actuaries or considered the information provided in their reports before rating the companies.

30.81 In our view, the examiners and analysts could gain a better understanding of a company and its risks from consulting with and seeking the advice of the OSFI actuaries on a regular basis.

30.82 Work of analysts and examiners sometimes not well co-ordinated. OSFI management told us that analysts consult with examiners when determining company ratings. However, we rarely found evidence of consultations in the files we examined, or in our discussions with examiners. In one case we noted, OSFI examiners and analysts had presented conflicting information to company management.

30.83 P&C division intends to improve. We found that P&C examiners do not always agree with analysts about company ratings. An April 1997 internal memo lists a number of companies to which the examiner and the analyst had assigned different ratings. However, by the end of our audit these inconsistencies had been addressed and a consensus reached on the appropriate rating. P&C division management told us it intends to implement a system of regular consultation.

30.84 OSFI should review the role of its actuarial staff and assess the level of resources needed to perform its regulatory role. It should improve the co-ordination of the work of actuaries, examiners and analysts.

Communication with companies needs attention

30.85 Companies want feedback. Adequate communication with supervised companies is important to ensure that they clearly understand OSFI's concerns. In addition, OSFI could provide value to the companies it regulates by giving them more feedback. The companies we consulted expressed a desire to learn more from OSFI about their performance in relation to that of their peers. They felt it would be particularly valuable to have information on whether actuarial reports prepared by the company actuary were more or less conservative than those of others in their peer group.

30.86 Frequency of meetings with boards of directors improving. Prior to 1997, OSFI met infrequently with the boards of directors of life insurance companies, other than those about which it had a significant concern. A list

of meetings provided by OSFI showed that on average, it met with four boards of directors each year from 1992 to 1997. In early 1997, it began to increase this number by meeting with the boards of major life insurance companies and companies where findings are significant.

30.87 Communication of actuaries' findings. Findings by OSFI actuaries in Ottawa are usually not communicated to the companies' appointed actuaries. As we have noted, companies would like more feedback on the quality of their actuarial reports. Regular discussions between OSFI's actuaries and company actuaries could provide useful information to companies and help improve the quality of actuarial work.

30.88 Examination reports slow and inconsistent. OSFI's reports to life insurance company management on examination results are not timely; they are often issued four to six months after completion of the examination. While examiners meet with company senior management at the end of each examination to obtain its comments on their observations, it is only when the final version is issued that the audit committee of the board is informed of the findings and recommendations. Most companies we interviewed, in both life insurance and property and casualty insurance, felt that OSFI should issue its report within two weeks after completing the examination. They suggested that if there are complex, contentious or unresolved issues, these can be noted in the report as items to be dealt with at a later date. These issues are relatively rare and need not hold up the report.

30.89 Furthermore, the content of these reports is not always consistent. OSFI is aware that they sometimes include issues that are not important enough to warrant bringing them to the attention of the board of directors. It informed us that, in future, an experienced OSFI manager will review management reports prior to their release to companies to ensure consistent quality control.

30.90 Disclosing the stage rating. OSFI does not inform a company when it is first classified at stage 1. We feel it is important that management be made aware of OSFI's view of the increased risk at an early stage, consistent with its mandate to act in a timely manner. OSFI has told us that in the future, it will inform all companies as soon as they are rated at stage 1. It advises the company and the Minister when the company moves to stage 2 or above.

30.91 OSFI should increase discussion with insurance company officials to better understand the company, and communicate its findings on a more timely basis to achieve better relationships and encourage improvements in company operations.

Need for continuous, documented communication with other regulators

30.92 Increasing importance of communication with other regulators. A number of features of the insurance industry make it important that OSFI communicate on a regular basis with other regulators, both foreign and provincial. For example, revenue from non-traditional sources is increasing for life insurance companies; they may now enter into transactions that are regulated by provincial securities exchanges. Also increasing is the proportion of Canadian life insurance companies' total profits that comes from their foreign operations. Many insurance operations in Canada, both life and property and casualty, are branches or subsidiaries of large foreign companies, which makes it imperative to communicate with foreign regulators (Exhibits 30.4 and 30.5).

30.93 Little evidence of communication. In the files we reviewed, we found little evidence of communication with other regulators. Companies we interviewed said OSFI did not request copies of foreign regulators' reports, even when they were carrying out their examinations at the same time. During our file review we noted that in two cases, the foreign regulator advised OSFI that it had issued an Order of Supervision placing restrictions on the company's activities, and that no funds would be transferred to the Canadian branch. Although OSFI had been aware of problems with a branch of one of these foreign companies and had rated it stage 1, it had not initiated any communication with the foreign regulator of the company. A more consistent approach to communication with foreign regulators is needed.

30.94 OSFI has taken some steps. At a senior level, OSFI communicates informally with foreign regulators and participates actively in international organizations such as the International Association of Insurance Supervisors. In December 1996, OSFI established the position of Special Advisor to the Deputy Superintendent of Policy. The Special Advisor is responsible for developing plans to improve relations with other regulators. OSFI told us a draft plan was prepared in May 1997.

30.95 There are a number of other, less formal measures that OSFI could take to improve communication. For example, it could request copies of all regulators' reports from the entities it examines and discuss with entity management the results of the other regulators' reviews.

30.96 OSFI should finalize and implement its plan to strengthen its relations with other regulators and should also pursue both formal and informal communications, focussing on incorporating specific entity information into the analyst's risk assessment.

Private Pension Plan Supervision

30.97 Pension Benefits Division. The Pension Benefits Division is responsible for the supervision of pension plans registered under the *Pension Benefits Standards Act 1985 (PBSA)*. Like the insurance divisions, it has sections for analysis, actuarial review and examinations. However, at the time of our audit there were only two pension examiners in Toronto and one in Montreal. OSFI plans to reassign two examiners in its Vancouver office to carry out pension examinations.

30.98 Pension plans are contractual arrangements under which money is set aside during the working life of employees to provide them with income at retirement. There are nearly 16,000 registered pension plans in Canada today, covering over 5 million employees, or about 45 percent of all employed Canadians. Most of these plans are subject to provincial jurisdiction and are regulated by provincial authorities. Some 1,100 plans, covering a little over half a million members in total, are regulated by OSFI (Exhibit 30.6).

Exhibit 30.6

Retirement Income Plans, Assets and Membership 1994

Type of Plan	Number of Plans	Assets (\$ billions)	Members (thousands)
CPP/QPP	2	54	12,912
RPP			
Regulated by OSFI ¹	1,100	45	501
Regulated by others	14,649	286	4,714
Total RPP	15,749	331	5,215
Federal government employee plans	20	122	459
RRSPs	-	182	5,110

Source: Statistics Canada, *Canada's Retirement Income Programs: A Statistical Overview (Feb. 1996) & Trusteed Pension Funds (1994)*

¹ Source: OSFI records

Continue to press for less overlap

30.99 Regulatory overlap is problematic. All jurisdictions, both federal and provincial except for Prince Edward Island, have enacted legislation governing the establishment and operation of pension plans. The requirements imposed by the various jurisdictions, while similar, are not identical. As a result, plans whose memberships cross jurisdictional boundaries find themselves subject to more than one regulatory authority and more than one set of regulatory requirements.

30.100 OSFI has taken steps to reduce overlap. To reduce the costs associated with regulatory overlap, OSFI has entered into agreements with provinces whereby it delegates authority to provincial regulators to supervise plans that have members who are subject to the *PBSA*, or accepts authority from the provinces to supervise plans with members who are subject to provincial jurisdiction. Currently, OSFI supervises some 25 pension plans on behalf of provinces. Supervision of approximately 124 pension plans has been delegated by OSFI to the provinces.

30.101 Reciprocal agreements do not reduce the largest part of the regulatory burden. These reciprocal agreements reduce regulatory costs by enabling plans to register with and be supervised by one regulator only. However, the regulator of a plan with members in different jurisdictions must apply separately the legislative requirements of the jurisdiction governing each plan member. This system can reduce the cost of compliance, the largest part of the regulatory burden, only to the extent that regulatory requirements are the same across jurisdictions. Unfortunately they are not, especially following changes to both federal and provincial pension standards legislation in the mid-1980s.

30.102 Multilateral agreements would be better. A more promising way of dealing with regulatory overlap is the “multilateral agreement” concept currently being promoted by the Canadian Association of Pension Supervisory Authorities (CAPSA). Unlike the reciprocal agreements now in place, multilateral agreements would allow multijurisdictional plans not only to register with a single regulator but also to be subject to the legislation of that regulator alone, regardless of the jurisdiction applying to individual plan members.

30.103 The compliance burden resulting from overlapping and inconsistent regulations has been a long-standing concern of pension plan sponsors and administrators. Despite recent initiatives through CAPSA and other forums, industry watchers and the industry representatives we interviewed say the situation is not getting better. As one of the major regulators of pension plans in Canada, OSFI can play a leading role in turning this situation around, by encouraging greater consistency in regulatory standards across jurisdictions and less overlap in supervisory requirements.

30.104 As part of its role in promoting greater consistency in the regulation of pension plans across Canada, OSFI should work actively with provincial regulators to promote the adoption of the multilateral agreement concept.

30.105 OSFI’s focus is changing. The key objectives of OSFI’s supervision of pension plans are to ensure that plan members can be reasonably confident that they will receive the benefits promised to them, and to monitor compliance with the *PBSA*. A major focus of OSFI’s regulatory activities to date has been on verifying whether plans comply with *PBSA* provisions and attendant regulations. This is a time-consuming and costly exercise — and in OSFI’s view, not particularly useful.

30.106 Plans for improvement. In December 1996, OSFI developed a draft guide to intervention for pension plans, similar to that for insurance. As part of its corporate plan for the next few years, OSFI has announced its intention to follow a more risk-based approach to regulating and supervising pension plans. It is currently in the process of developing a risk-rating system, an electronic database on pension plans similar to the existing database on insurance companies, and *Standards of Sound Governance and Financial Practices*. Once completed, these projects should make supervision of pension plans under the *PBSA* more effective and efficient.

Integrate monitoring and examination

30.107 Increasing use of examinations. On-site inspection of pension plans plays an increasingly important role in OSFI's approach to supervision. Prior to 1990, it carried out only two or three examinations a year. Since then, an objective of the Pension Benefits Division has been to complete 40 to 60 examinations each year. In practice, the actual number of examinations carried out each year has been in or below the lower part of this range.

30.108 Examinations and monitoring processes need improvement. The increased reliance on on-site inspections over the past several years has proved useful. However, our review of pension files revealed the same types of problems as we found in the insurance area — quality controls and attention to actuarial information need improvement. For example, the rationale supporting the risk rating of a pension plan was not evident. In fact, each analyst had his or her own risk-rating system and there was no evidence that senior management reviewed or approved the ratings. The implementation of OSFI's new guide to intervention for pension plans is expected to remedy this problem. We also found little evidence of the development of systematic action plans for dealing with troubled pension plans, and examination reports to plan administrators were not timely.

30.109 As in the Insurance Division, our file examination found little evidence of communication among pension plan analysts, actuaries and examiners. The examination process could be made more effective and efficient by integrating the monitoring and examination functions at OSFI.

30.110 Increased participation of OSFI's Ottawa analysts in the examination process could enhance communication between examiners and analysts, sharpen the focus of examinations, and cut down the time required to be on-site.

30.111 OSFI does recognize shortcomings in the existing examination process. It is planning to rectify them by narrowing the scope of examinations to areas sensitive to plan solvency and by allocating more of the examination work to analysts, actuaries and other non-examiner staff at headquarters.

30.112 In its ongoing review of the existing supervisory process for private pension plans, OSFI should encourage a closer integration of the monitoring and examination functions in the Pension Benefits Division. It should pay more attention to quality controls and actuarial information and strive for greater consistency in the risk-rating process.

Conclusion

30.113 Accountability framework has improved. We concluded that OSFI has achieved a clear accountability framework for its insurance operations by establishing a mandate, strategic objectives, standards of sound business practice and a guide to intervention. Plans are in place to develop a similar framework for pension plans. OSFI is continuing to enhance the framework by developing performance measures, and has begun to address the issue of compliance in a more comprehensive way by stressing company management's responsibility for compliance with Acts and regulations.

30.114 Risk assessment systems need to be enhanced. Through the establishment of standards and guides, OSFI has improved its systems and procedures for assessing the risk that individual entities pose for policyholders or plan members, although implementation is uneven. OSFI's increased emphasis on key risks and solvency issues helps it to detect problems early. However, its ability to respond would be improved if operating units were better integrated and if co-ordination and communication with regulated entities and with other regulators were improved.

30.115 Human resource management requires better analysis and links to future strategic direction. OSFI management has expressed concern about difficulties in obtaining qualified staff with appropriate skills. A number of initiatives are under way to try to address these concerns. However, OSFI needs to clearly set out its assessment of these initiatives, based on well-researched information and a clear rationale linking them to its regulatory strategy for the future.

30.116 OSFI is making progress on meeting needs for the future. OSFI has conducted a number of studies in the past year covering potential risks facing the financial services industry in the future. While it has incorporated the findings of some studies into its operations, in other cases the use of study results has been less evident. OSFI has plans in place to meet the challenges of increased industry complexity and globalization, through harmonization of regulations and both formal and informal sharing of information with other regulators. However, it needs to pay more attention to regulatory incentives that enhance the efficiency of the regulatory system.

30.117 Continuous improvement needed in response to increasingly rapid changes in the financial services industry. OSFI has made significant progress since its inception 10 years ago. Its philosophy and processes are becoming increasingly sophisticated. Although OSFI meets the needs of today's environment, it nevertheless needs to address important gaps that could affect its ability to meet its objectives in the future.

OSFI's response: The Office of the Superintendent of Financial Institutions (OSFI) is in general agreement with the observations and findings arising out of the audit of OSFI's insurance and pension operations.

While there are a few conclusions that, in our view, miss the mark, we agree with the majority of the audit findings and accept the recommendations resulting from them. Indeed, in many cases, the recommendations support initiatives already under way within OSFI.

Beyond the audit's specific conclusions, we believe that the chapter fairly portrays the progress we have made to date in enhancing our regulatory and supervisory processes, while highlighting the significant challenges that we face in keeping pace with the rapid changes taking place within the financial sector.

The chapter is particularly supportive of the work under way within OSFI to develop an accountability framework, including a mission statement, strategic objectives and performance measures. We wish to acknowledge the advice and encouragement we are receiving from the Office of the Auditor General as we work to develop standards in a field in which few precedents are available.

About the Audit

Objectives

We developed our detailed audit objectives and audit criteria in light of the changes in the legislative framework and the increasing risks to the entities OSFI regulates, and ensured that they were related to OSFI's strategic objectives and were future-oriented.

The objectives of this audit were to determine whether OSFI, with respect to its insurance and pensions operations:

1. has a clear mandate, roles and responsibilities as well as adequate quality controls and reporting to meet its accountability requirements, and more specifically whether it:
 - knows if its objectives are met in a cost-effective manner for the entities regulated; and
 - has complied with the requirement to administer respective Acts and regulations governing its operations.
2. has adequate and efficient systems, procedures and capabilities to safeguard policyholders and plan members from undue loss, and more specifically whether it:
 - has adequate resources, including staff, to carry out its work;
 - has developed and implemented the appropriate systems and practices to assess the soundness of insurance companies and pension plans under its jurisdiction as well as their compliance with relevant Acts and regulations;
 - has the ability to detect early, and respond to, deteriorating situations; and
 - is effectively communicating and sharing information on a timely basis with related organizations.
3. contributes to public confidence by anticipating future challenges and adjusting its activities to meet them.

Scope

Our audit covered OSFI's supervision of insurance and pensions, concentrating mainly on operations during 1996. We completed our field work at the end of May 1997. However, we considered information available up until completion of the audit report on 15 September 1997.

While our focus was on OSFI's Operations Sector, we also covered policy and corporate services where they have a major impact on Insurance and Pension operations. OSFI's own financial operations are audited annually during our public accounts audit. In 1994, we carried out a more detailed audit of OSFI's financial management for public accounts purposes. Based on our work, we consider financial management and control in OSFI's own operations a low-risk area and did not cover it in the scope of this audit.

We did not audit OSFI's activities with respect to the liquidation of insurance companies. In our 1986 audit of the Department of Insurance, the Department provided us with information on the process for handling insurance company liquidations and we commented on it. During the present audit, OSFI pointed out, and we concur, that the audit of the liquidation function is beyond our mandate. The Superintendent has been appointed, under authority of the *Winding Up Act*, as liquidator for many failed insurance companies. In this role, he is accountable to the courts. As a result, we were not able to examine whether the Superintendent, in his role as liquidator, has met the requirements under the *OSFI Act* to protect policyholders while taking into account impacts on competition (under recent changes to the legislation, the Superintendent will no longer be appointed liquidator). As a consequence of these limitations, we were not able to determine whether OSFI's monitoring under the new regime will be sufficient to protect policyholders. At the time of our audit, the Superintendent was in the process of liquidating 10 property and casualty insurance companies and two life insurance companies. OSFI was unable to provide us with the total estimated costs of liquidating these companies, including agent and legal fees and administrative expenses. The cost from the date of liquidation to 31 March 1997 amounted to \$88.6 million, of which \$46.2 million had been recovered from the estates of the liquidated companies. Costs that are not recovered from estates will be recovered from the insurance industry. The costs incurred in 1996-97 totalled \$1.9 million.

Our audit also covered the Office of the Chief Actuary. However, certain parts of his work were excluded. The Auditor General's annual audit of the government's financial statements includes the Chief Actuary's valuation of government employee pension plans. Also, our audit of CPP Disability, reported in September 1996, included the valuation of the CPP. Therefore we did not examine the adequacy of actuarial valuations performed by the Chief Actuary.

Approach

Our audit included the review of monitoring, examination, corporate analysis and actuarial files in Ottawa, Toronto, Winnipeg, Vancouver and Montreal. We examined all companies and pension plans rated at stage 1 and higher. In determining whether OSFI met the audit criteria, we examined nearly 250 files. We also conducted interviews with OSFI staff at headquarters and in the regional offices, at various levels. We conducted interviews with senior management and industry representatives of 32 life insurance companies, property and casualty insurance companies and pension plans. We also reviewed more than 200 documents including OSFI publications, internal audit reports, industry publications, Acts and Regulations and OSFI Guidelines for Industry.

Criteria

Risk assessment

OSFI should have in place an effective process to guide staff in the work to be done that results in the timely identification of solvency and compliance problems.

OSFI should use a risk-based approach to identify companies/plans that require in-depth work and to identify key areas in a company/plan that require further investigation to ensure that potential problems are properly understood and evaluated on a timely basis.

There should be clear and timely communication of requirements and findings, with the company/plan, OSFI staff in related sections and other agencies or regulators.

Risk management

There should be a framework for intervention that is well understood by OSFI and regulated institutions.

There should be an action plan that considers possible remedies to a problem and ensures that they are corrected in a timely manner.

Anticipation of future challenges

OSFI should have a plan and process for system-wide and cross-system studies and use the results in other relevant areas such as examinations, monitoring and rulings, to identify potential problems and to ensure that its processes will be adequate in the future.

Mandate and accountability

OSFI should have a clear mandate, converted into a clearly articulated mission with specific goals, objectives and plans.

OSFI should have in place effective agreements with provinces, related federal departments and guarantee agencies. OSFI should have in place documented procedures for liaising with foreign regulators. The agreements and procedures should provide a clear understanding of each organization's roles and responsibilities. The agreements and procedures should also provide an operational framework that includes the timely sharing of information and the best use of legislative powers, recognizing the limitations imposed by other regulatory frameworks.

OSFI should periodically measure its results against predetermined performance criteria and report those results to the Minister, to Parliament and to other stakeholders.

OSFI should make use of key performance measures, including quality control processes, to improve its operations and accountability.

OSFI should identify the key requirements of respective Acts and regulations and ensure that it meets those requirements. OSFI should identify on a timely basis the adequacy of the existing legislation and regulatory policies, including any gaps.

OSFI should make use of information technology for cost-effective operations.

Human resource management

OSFI's organization structure and delegated responsibilities should permit the effective realization of its mandate. OSFI should have adequate staff with the necessary skills to perform the work required.

Audit Team

Art Miskew
Norah Roberts
Yvon Roy
Aline Vienneau
Basil Zafiriou

For further information, please contact Crystal Pace, the responsible auditor.

Chapter 31

Revenue Canada

The Financial Management Regime

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(This exhibit is not available, see the Report)

Revenue Canada

The Financial Management Regime

Assistant Auditor General: Shahid Minto

Responsible Auditor: Basia Ruta

Main Points

31.1 Revenue Canada's 40,000 employees dispersed across 800 offices collect about \$850 million and disburse some \$425 million on average each working day.

31.2 The sheer size of Revenue Canada, the importance of its contribution to sustaining other government programs and its high visibility to taxpayers require a strong commitment to effective financial management. In the aspects of financial management examined during our audit, we found some areas of strength and no areas of neglect. We also noted several areas in need of improvement. Revenue Canada has gone through a period of tremendous change, both organizational and legislative. It is now at a stage of maturity where it needs to give more attention and a higher priority to financial management.

31.3 The Department has been proactive at establishing corporate plans and strategic documents that are linked to government objectives and priorities. Management agreements are being used to help promote a common vision and strengthen managers' accountability.

31.4 Revenue Canada's performance in the prompt deposit of billions of dollars of payments it receives from taxpayers at its offices and ports is generally satisfactory. Our tests show that the vast majority of taxpayer remittances are deposited by the next business day. Still, opportunities exist to improve departmental performance in this area and generate several millions in potential interest revenue for the government each year.

31.5 Revenue Canada's practices in the monthly reporting of revenues require more rigour. Basic accounting systems in support of \$18 billion in annual deposits by Customs need to be modernized considerably.

31.6 Deficiencies exist in other formal systems and practices pertaining to key areas of financial management. Informal information systems, proxy measures or other mechanisms are being used in an effort to bridge those deficiencies. Some of the shortcomings have a multiplier effect on financial risks to the public purse, and impact on other federal-provincial programs whose benefits or credits are tied to information contained in Revenue Canada's systems. Departmental initiatives are either planned or under way to address some shortcomings.

31.7 We have significant ongoing concerns about the reliability of information meant for use in monitoring and analyzing program statistics, trends and performance. As Revenue Canada becomes increasingly reliant on using information in diverse ways to monitor and support its programs, there is a crucial need to clean and purify data to remove any inaccuracies and ensure that they are in an appropriate form for analysis.

31.8 Although responsibility for financial management is shared and decentralized among headquarters, program and regional operations, Revenue Canada does not review or co-ordinate systems and practices Department-wide. Nor has internal audit been used effectively to provide independent overall assurance on the state of financial management and control across the Department.

Introduction

Few organizations compare with Revenue Canada in the size and range of financial transactions

31.9 Few organizations compare with Revenue Canada in the size and range of financial transactions that typify its daily operations. These transactions cut across virtually every program and activity the Department administers. During 1995-96, Revenue Canada collected over \$212 billion and spent about \$2 billion to run its own operations. As illustrated in Exhibit 31.1, it disbursed more than \$45 billion in the form of federal tax refunds, drawbacks and social benefit payments to millions of Canadians. This was in addition to over \$62 billion in direct cash transfer payments to the provinces, the Employment Insurance Account and the Canada Pension Plan. In total, these transactions represent about \$850 million collected and some \$425 million disbursed on average each working day.

Exhibit 31.1

Revenue Canada's Volumetric and Dollar Transactions

- 21.8 million individual income tax filers
- 205,000 trusts
- 1.1 million corporations
- 2.4 million goods and services tax (GST) registrants
- 1.3 million employers
- 158,000 commercial importers
- 107 million travellers
- 23,000 registered pension and deferred profit sharing plans
- 74,000 charities
- \$258 billion in trade representing more than 30.9 million commodity declarations resulting from 10.9 million commercial entries
- 17.1 million public enquiries
- 467,000 Children's Special Allowance payments
- \$212 billion in gross receipts
- \$45 billion in tax refunds, drawbacks and social benefit payments
- \$62 billion in direct cash transfer payments to the provinces, the Employment Insurance Account and Canada Pension Plan

Source: Revenue Canada's 1997-98 Estimates, *A Report on Plans and Priorities*, and 1995-96 Performance Report - Revenue Canada

31.10 Not reflected in these figures are other sizeable financial operations for which Revenue Canada is responsible. They include, for example, tens of billions of dollars of indirect annual expenditures in the form of assessed tax deductions and credits on taxpayer returns — that is, tax expenditures. They also encompass the Department's \$9 billion inventory of tax debts, and an estimated \$800 million investment in facilities and other capital assets.

For Revenue Canada, a strong financial management regime is crucial

31.11 The sheer size of Revenue Canada, the importance of its contribution to sustaining other government programs and its high visibility to taxpayers require a strong commitment to effective financial management and control of its expenditures, revenues and assets. The ability to recognize and implement opportunities to enhance

efficiency and cost-effectiveness in operations can mean millions of dollars in savings or additional revenue for the government. Timely identification and correction of even minor inefficiencies or of extremely small rates of leakage in revenues or expenditures could translate into millions of dollars of cost avoidance or increased revenues. For example, in 1996 we reported that the Department's efforts to promote direct deposit of benefit payments were estimated by the government to have generated some \$7 million in annual savings on postage, banking and paper costs. Conversely, in 1994 we reported that each one-cent drop in average cash recovered for each dollar of income tax debt resolved cost the treasury \$34 million, and that opportunities existed to enhance departmental performance in this area. In paragraph 31.88, we note that a discrepancy of less than one percent in cost estimates relating to two projects alone amounted to approval of about \$700,000 in excess funding. What these examples show is that, given the size of Revenue Canada's operations, individually the absolute dollar effects of factors such as errors, discrepancies and missed opportunities for enhanced efficiencies and cost-effectiveness are significant, and cumulatively they are potentially huge.

31.12 Exhibit 31.2 sets out the major elements of financial management. In our view, there are five elements that must be in place to achieve effective financial management. They are: appropriate systems; effective financial controls; effective measurement of results; objective analysis backed by accurate, timely, and relevant information; and necessary links from that analysis into departmental decision making and formal accountability structures.

Exhibit 31.2

Financial Management Elements

Financial management elements include, among other things, the systems, policies and procedures needed in an organization to provide reasonable assurance that:

- financial risks are appropriately identified and managed;
- relevant, accurate and reliable information is available to decision makers on a timely basis to understand the financial implications of decisions before they are made;
- assets and public money are properly safeguarded and protected against losses;
- money is expended and collected with due regard to economy, efficiency and effectiveness and in accordance with executive financial authorities, laws and principles;
- financial results are reliable, timely and accurately reported;
- financial performance is appropriately monitored; and
- management is held accountable for the results it achieves.

Taking note of Revenue Canada's daunting change environment

31.13 During the past several years, the Department has faced tremendous changes in both its legislated responsibilities and its organization, and continues to do so. In the fall of 1992, the announcement of the administrative consolidation of Customs and Excise with income tax operations turned Revenue Canada — almost overnight — into one of the largest federal government departments. Like other government entities, Revenue Canada had to reduce its spending and deal with the government's Program Review exercise. Program Review confirmed the Department's mandate in all respects, and reduced its annual base funding by a few hundred million dollars. Throughout the past four-year period, many employees either were displaced or were placed in several interim and acting positions. New systems had to be introduced without disrupting regular operations. During that period, Revenue Canada also assumed new responsibilities formerly carried out by other departments, and entered into cost-sharing and partnering arrangements for either collecting the GST or distributing social benefits.

31.14 Currently, the Department is anticipating a period of further significant change as it deals with the government's stated intention to record taxes on some form of accrual basis and transform it into a revenue

collection agency. If the revenue agency concept materializes, it will most certainly create substantial additional pressures on financial management.

Progress made in issues raised by past audits

31.15 In the past several years, our audits of many of the Department's programs have reviewed aspects of financial management. Although a number of our observations in those areas were positive, we also observed several apparent deficiencies, many with significant implications for the public purse, the management of the government's finances or the integrity of the tax base.

31.16 Chapter 18 of our October 1997 Report noted the Department's progress in dealing with our observations in the 15 audits we reported on from 1992 to the spring of 1996 inclusive. While we conclude in that chapter that we are generally satisfied with actions the Department has taken to bring about a number of improvements in almost all areas, much more remains to be done. Given the financial risks and the dollar amounts involved, sustained effort to resolve the matters still outstanding from our previous audits is essential.

Focus of the audit

31.17 Our objective for the audit was to determine whether, in the areas examined, the financial management regime in place was sufficient to provide adequate safeguards to minimize financial risks and protect financial assets, and sufficient to support management in its efforts to achieve its program objectives in an efficient and cost-effective manner. We considered, among other things, the Department's performance in dealing with financial management observations in our previous audits as well as in two of its key fiduciary responsibilities.

31.18 Our audit concentrated on Revenue Canada's financial management systems and practices in the period from the administrative consolidation of the two former revenue departments until June 1997. Further details on our audit scope, objectives and criteria can be found in **About the Audit** at the end of the chapter.

Observations and Recommendations

Key Fiduciary Responsibilities

31.19 Two of Revenue Canada's key fiduciary responsibilities are to ensure the prompt deposit of billions of dollars of taxpayer remittances and to report to central agencies on revenues collected. We also considered Revenue Canada's performance in supplying other financial information to key stakeholders for input into tax policy or to support financial reporting requirements of the federal government.

Majority of tax payments are made directly at financial institutions and through electronic funds transfers

31.20 Cash management. As the primary revenue collection point for the federal government as well as most provincial governments, Revenue Canada is responsible for collecting over \$200 billion annually in customs, excise, income tax (federal and provincial) and GST, as well as Canada Pension Plan and Employment Insurance premiums.

31.21 Using 1995-96 figures, Exhibit 31.3 shows that \$119 billion or 59 percent of overall tax payments are made at financial institutions. A further \$15 billion or 7 percent are transferred directly from the taxpayers' banks to the Receiver General through electronic funds transfer. The balance, some 34 percent or \$69 billion, is collected

directly by Revenue Canada at its offices and ports, with \$4.6 billion of that amount, or 2 percent overall, collected by the Ministère du Revenu du Québec on behalf of Revenue Canada for GST in that province.

Exhibit 31.3

(This exhibit is not available, see the Report)

31.22 The best scenario for cash management is to have tax remittances deposited in government bank accounts on the day they are received from the taxpayer. With the funds available for immediate use, the government can either avoid interest on short-term borrowing or earn interest by investing the funds.

31.23 Cash management also benefits from direct payment by taxpayers at a financial institution or through electronic funds transfer. As a result of agreements between the Receiver General and the direct-clearing financial institutions, if the funds are not transferred to the Receiver General the same day, the government will still earn interest on them, whereas amounts received at Revenue Canada but not deposited in government bank accounts the same day will not. Revenue Canada has arrangements in place to accept electronic funds transfers and to allow taxpayers to remit income tax, domestic GST, and excise at any branch of Canada's major banks and credit unions. However, for amounts levied by Customs, including GST on imported goods, there is currently no system for bank remitting. As for electronic funds transfer, the Department has indicated that brokers and importers can remit in this way but, except for one importer, none have arranged to do so.

31.24 We examined the extent to which legislation is supportive of bank remitting for each of the revenue streams, and the timeliness with which funds received directly at Revenue Canada offices are deposited. Regarding the adequacy of legislative support for bank remitting, we note that the Department of Finance is responsible for the related policy provisions embodied in legislation. However, Revenue Canada is expected to advise the Department of Finance on suggested legislative changes as it deems appropriate.

Mandatory bank remitting for some revenue streams, but not customs and excise

31.25 While it is not mandatory for payment of corporate or personal income tax, the law requires that average monthly remittances of \$50,000 or more for source deductions by employers (the largest source for income tax) and remittances of \$50,000 or more for domestic GST be made at a financial institution. We found that income tax and domestic GST have high rates of bank remitting, compared with little or no bank remitting for other revenue streams, as shown in Exhibit 31.3.

31.26 Mandatory bank remitting provisions do not exist for customs payments, GST on imported goods, excise duties and levies. These represented some \$26 billion in cash receipts in 1995-96; only \$1.1 billion of \$8.1 billion in excise duties and levies (13.5 percent) were remitted directly at financial institutions on a voluntary basis. The balance of excise payments and all of customs levies, including GST on imported goods — about \$25 billion in total — were paid at Revenue Canada offices. As noted in the preceding paragraphs, the Department has not made voluntary bank remitting possible for amounts levied by Customs. We note that almost 78 percent of income taxes were bank remitted in 1995-96 (statistic includes electronic funds transfers) compared with 13.5 percent of excise taxes.

31.27 Beyond cash management considerations, we are also concerned that the disparity across revenue streams in legal requirements for mandatory bank remitting impacts considerably on the fair and equitable treatment of taxpayers. Many monthly remittances by importers and brokers are in the tens of millions of dollars, and several are in the hundreds of millions of dollars. For source deductions and domestic GST, such sums have to be paid by taxpayers at financial institutions — if not, they may be subject to penalties and/or interest. However, under existing legislation, importers and brokers are not faced with such penalties. Moreover, paying at Revenue Canada offices may result in a delay of a day or more before remittance payments are actually drawn from taxpayers' bank accounts. This provides an unfair advantage to importers and brokers in terms of cash flow or potential interest generated. The same inequities exist for those required to remit excise payments. There are similar inequities for

personal and corporate income taxes: for income tax, as noted above, only source deductions are subject to mandatory bank remitting.

31.28 Since the administrative consolidation of the two former revenue departments, Revenue Canada has been proactive in suggesting legislative changes to harmonize provisions of the law across revenue lines. It has highlighted many inconsistencies, including those that pertain to mandatory banking requirements. Proposals for harmonizing legislation are in the hands of Finance.

31.29 The Department of Finance should seek legislative changes to have customs and excise payments, GST on imported goods, and personal and corporate income taxes be subject to mandatory bank remitting provisions comparable with those for source deductions and domestic GST, to ensure the fair and equitable treatment of taxpayers. As part of the exercise, it should also seek legislative changes to ensure appropriate penalty provisions in support of enforcement of mandatory bank remitting across revenue streams.

Department of Finance's response: The Department of Finance agrees in principle that it may be desirable to require large remittances of all types of revenue to be made at financial institutions. Finance is currently considering this issue with Revenue Canada through its broader review of interest and penalty provisions and will recommend appropriate legislative measures once the review is completed.

31.30 Revenue Canada should implement a bank remitting system for Customs as soon as possible to accommodate voluntary bank remitting, and ultimately mandatory bank remitting as approved by decision makers.

Department's response: The amalgamation of Revenue Canada, Taxation and Revenue Canada, Customs and Excise into one department provided the opportunity and the impetus to integrate all of the revenue programs it administers. This process of integration to develop a single or standard accounting system, which is at times referred to as re-engineering, began in 1995 and covers a period of several years ending in the year 2002. The capability to allow financial institution remitting for all revenue streams is a part of this initiative.

Revenue Canada deposits majority of receipts by the next business day

31.31 With receipts of \$69 billion flowing through Revenue Canada offices for 1995-96 alone, timely deposits of receipts can result in several million dollars in additional interest revenue or, alternatively, in savings on interest expense for the government each year. Consequently, we expected that the Department would give strong direction concerning cash management in the field. While the Department has a clearly established policy that all offices and ports should schedule a bank deposit if total receipts for the day exceed \$500, it is less clear about the standard of performance expected. For example, we found no expected standard of performance for the timeliness of deposits by Customs offices. For the rest of the Department, we found a policy calling for deposit of remittances within 24 hours during regular or peak periods, and the maximizing of same-day deposits. However, no performance targets were provided for same-day deposit.

31.32 We wanted to analyze the information generated by the Department to monitor its performance in timeliness of deposits, but found that existing reports were not relied on in the field and, in the case of deposits by Customs, that no reports were produced. Therefore, to assess Revenue Canada's promptness in depositing receipts, we selected sample items from either 1995-96 or 1996-97 to compare the date of remittance with the date of deposit. Because of differences in the systems used in the various business lines to process deposits, and the variation in the information they capture electronically from source documents, our approach to sampling varied. We did not test the GST remittances collected by the Ministère de Revenu du Québec (not reflective of Revenue Canada's performance).

31.33 The results of our testing were generally satisfactory, notwithstanding the lack of effective cash monitoring systems in each revenue stream: between 22 percent and 26 percent of the dollar value of remittances in our sample were deposited the day they were received, and 76 percent to 100 percent were deposited by the end of the next business day (Exhibit 31.4).

Exhibit 31.4

(This exhibit is not available, see the Report)

31.34 We found that performance varied by month, by office and by revenue stream, suggesting that the high level of performance observed in some offices is more likely attributable to the level of understanding among Revenue Canada employees of the importance of making prompt deposits than to a comprehensive cash management regime. Also, internal audit's attention to aspects of cash management likely offsets to some extent the weaknesses apparent in day-to-day monitoring. Without vigilant monitoring and improvement of performance, and seeking out opportunities to improve systems, Revenue Canada risks forgoing several millions of dollars in potential interest revenue for the government each year.

Opportunities exist to improve performance

31.35 Our testing revealed that opportunities exist to improve cash management in cost-effective ways, using the existing systems. For example, we identified the following opportunities :

- **Customs.** Seven of the 37 randomly selected daily deposits were from one large Customs office. We found that no same-day deposits had been made on any of these seven month-end dates. In one of the seven cases, the full daily receipts of \$290 million dollars were left undeposited for four days because the month-end fell on the Friday before a long weekend. By way of contrast, most of the other offices included in our sample showed at least some same-day deposits, with a few offices showing same-day deposit for all receipts. The \$290 million left undeposited for four days translates into lost interest of between \$73,000 and \$178,000 at that one office. The interest lost by the failure to make any same-day deposits for all of the seven month-end dates in our sample from that office would amount to \$283,000 to \$690,000. As noted in paragraph 31.31, Customs has yet to clarify a standard of performance for promptness of deposits.

- **Income tax and domestic GST.** We took a sample of three months from 1996-97, excluding mail-in remittances at the GST processing centre. We found that the performance on same-day and next-business-day deposits varied significantly among offices, even in the same region (Exhibit 31.5). The overall rate of next-business-day deposit for each of the three months analyzed was considerably lower than required by departmental policy for Tax Centres and Tax Services Offices. The Department informed us that subsequent to our audit it issued a directive clarifying the policy to include an expected minimum standard of 90 percent processing by next business day. Of the three months tested, October was the only month in which the overall rate of next-business-day deposit would have met that revised standard. We noted that the proportion of remittances that was deposited by the end of the next business day was only 65 percent in April, compared with 82 percent in August and 90 percent in October.

Exhibit 31.5

(This exhibit is not available, see the Report)

Our analysis of the month of April, in which only 65 percent of the dollars were deposited by next business day, shows that 90 percent of the dollars were not processed until up to seven days after receipt, and significantly longer for the remaining 10 percent. This could indicate that insufficient resources were devoted to processing deposits at this peak period of the taxation year. This translates into interest of \$285,000 lost to the government on amounts in April that were left undeposited beyond the next business day, adjusted to reflect a 90 percent standard of performance. For the remaining 10 percent, interest lost was significantly higher — \$362,000 — because of

excessive time lags in depositing cash at the bank. The total interest cost to the government for failing to deposit all receipts by next business day for the month of April was therefore \$647,000.

Similarly, for the month of August, the imputed lost interest due to slow processing of deposits amounted to \$43,000 on 90 percent of the receipts and \$131,000 on the remaining 10 percent, for a total of \$174,000. Even in October, when the overall performance met the minimum standard of 90 percent deposited by the next business day, the interest forgone on the remaining 10 percent by failing to deposit by next business day amounted to \$127,000. Combined, as shown in Exhibit 31.6, the total interest lost to the government by failing to meet next-business-day deposit on all receipts at Tax Centres and Tax Services Offices for the three months covered in our test amounted to \$948,000, using the average 3 percent interest rate in effect for 1996-97 between the Receiver General and the direct-clearing financial institutions.

Exhibit 31.6

(This exhibit is not available, see the Report)

31.36 Revenue Canada should establish, by line of business, clearer standards for acceptable time frames for deposit of remittances including clear targets for same-day deposit of receipts. It should monitor departmental adherence to those standards, and ensure that adequate resources are deployed during peak periods to support principles of sound cash management.

Department's response: Revenue Canada considers the prompt deposit of all remittances to be very important, and, to that end, has published time frames in all procedures manuals for staff. The monitoring of departmental adherence to these standards is performed at both the regional and local office levels.

In addition, in February of 1995, a team was put together to look at the entire payment process system in Revenue Canada, and to re-engineer it using the latest technology. This includes scanning and imaging to replace manual keying operations. We are in the process of developing a new Payment Processing System (PPS) to replace most of the current payment processing systems in the Department. All of these technological improvements will improve the level of performance. Phase 1 of the new Payment Processing System is scheduled for implementation in 1998.

Although additional resources are added during the peak period of the taxation year, there are some fundamental, costly restrictions such as space and equipment that make the management of peak workloads challenging. We are, however, looking at new ways of payment processing such as automated payment machines, which should help alleviate the workload peaks.

Better systems needed to process excise remittances and deposits by Customs

31.37 Although we found that all amounts selected for our testing had been deposited in the bank, the deposit system used at Customs does not efficiently support the \$18 billion in cash receipts processed annually. Over \$14 billion of the receipts by Customs pertain to GST paid on imported goods. Individual offices have implemented manual forms and procedures to bridge shortcomings in an archaic national deposit system, which is largely manual. The labour-intensive nature of the Customs system raises serious questions about the cost-effective use of resources — resources that might otherwise be used to improve performance in remitting deposits promptly in the bank. Given the billions of dollars involved and the inefficiency of the manual process, the need for changes in supporting systems and practices seems evident. Subsequent to our audit, the Department informed us that changes to these systems would be considered as part of its re-engineering efforts.

31.38 Another example of inefficiency is the lack of transfer accounts that would allow financial institutions to transfer excise payments directly to the Receiver General. Banks must accumulate the total remittances they receive and forward a cheque to a Revenue Canada office for redeposit. As illustrated in Exhibit 31.3, about \$1.1 billion of excise payments are remitted at banks. A manual system is then used by Revenue Canada to track interest to be

charged to the banks for the period between the date taxpayers remit at the bank and the date the banks provide a cheque to the Department for redeposit. This system is not efficient because it is highly manual and duplicates effort. The Department has informed us that changes to eliminate the inefficiency are planned for the fall of 1997.

31.39 Revenue Canada should update Customs' systems to provide staff with a complete and effective set of tools for processing its large amounts of cash receipts.

Department's response: Revenue Canada recognizes this concern and is committed to rebuilding the current Customs system as part of its five-year plan to re-engineer all its business processes. Specifically, the Department plans to move the Customs processes to the new standardized accounting system in the year 2002. The timetable for this re-engineering is based on an analysis of the requirements of all business systems.

At this time, it would not be cost-effective or practical to effect these changes independently, as the time frames for system development would take two to three years. This would then be redundant a short time later with the implementation of a single or standard accounting system. During the intervening period, a number of interim measures are being implemented to manage payment remittance until the new accounting system is fully implemented.

Revenue Canada's performance in revenue reporting needs improvement

31.40 Revenue reporting. Revenue Canada needs to update its systems and practices to efficiently support the financial information reporting requirements of the Government of Canada.

31.41 While the Department is coming closer to meeting the timetable set by the Receiver General for year-end reporting, the Department of Finance has continuing concerns about the timing of the release of Revenue Canada's final figures. It believes that Revenue Canada should have these available much sooner than the usual two and a half months following the fiscal year-end that the Receiver General timetable provides. In addition, Finance has noted problems with the lack of information available in the form of analyses or other volumetric information that would provide additional comfort on the revenue numbers supplied for release in the monthly *The Fiscal Monitor* and/or the annual Public Accounts of Canada.

31.42 Timeliness and reliability of revenue reports are critical issues for monitoring the performance of tax and fiscal policy measures and ensuring the credibility of government financial reporting. Finance indicated that it cannot analyze actual results until three months after the year-end because of significant variations between preliminary year-end and final figures for overall revenues being reported. Moreover, published interim financial information on revenues collected has had to be restated in the past. In particular, material misstatements between net personal income taxes and net corporate taxes had to be corrected in 1994-95, spanning several months. Similarly, during that same period, separate concerns about the quality of previously reported excise revenue numbers also resulted in restatements in *The Fiscal Monitor*. These errors could have been either detected earlier or prevented had Revenue Canada been reconciling its operational records to the federal government's books on a timely basis. In addition, Revenue Canada could have exercised more rigour in analyzing the reasonableness of the distribution of the monthly revenue amounts reported externally for the various taxes.

31.43 Since 1994-95 there have been no other restatements in the revenue amounts published in *The Fiscal Monitor*. Over the past few years, the Department has been devoting increased attention to revenue reporting matters, and there have been some notable improvements evident in the revenue reporting processes and practices. In addition, over the next five years, a number of initiatives are under way to re-engineer the Department's accounting and related processes, at an estimated cost of over \$100 million. Notwithstanding the Department's improvements in revenue reporting matters and the re-engineering projects under way, in our view much more is still needed to ensure timely and accurate revenue reports by stream of revenue.

31.44 Our analysis of Revenue Canada's performance indicates four areas of weakness that continue to impact on revenue reporting. They pertain to:

- systems;
- standards of performance;
- reconciliations; and
- analyses.

31.45 Systems. Revenue Canada's key problem is that many of the existing systems that support the reporting of revenues in the central accounts of the federal government are very inefficient, disconnected and cumbersome. Finance and Administration at headquarters relies on program branches to process details for tax deposits, remittances, and other revenue transactions such as refunds and credits. It takes significant resources and efforts by the Department's Finance and Administration revenue reporting section to draw information from the many feeder systems and to account for the completeness of information associated with tax deposits and other transactions. The process is slow, archaic and highly labour-intensive; it also makes fundamental bookkeeping activities, such as reconciliations, difficult to perform. The risks to proper financial reporting are obvious. In addition to the systems upgrades envisaged as part of re-engineering, more automated tools and systems are clearly and urgently needed. Among others, these would include automated matching of revenues reported in departmental systems to deposits recorded in the government's central accounts; at present, this process is largely done manually. And, as discussed in paragraph 31.37, they would also include automation of the manual systems that provide the input into feeder systems.

31.46 Revenue Canada has indicated that one of the objectives of re-engineering is to remove several of the inefficiencies of the current systems. For example, it is intended to integrate client account information with information for assessing and for revenue reporting, thereby eliminating much of the disconnectivity that now exists. The anticipated features of the new systems also include an integrated general ledger, something that the current system does not have, and something that is fundamentally important for revenue reporting purposes. The re-engineering is also intended to efficiently support accounting for tax revenues on an appropriate accrual basis, should the government follow through on its intention to do so.

31.47 Standards of performance. Feeder systems supporting revenue reporting practices are of varying quality; some are labour-intensive; and some are largely automated. Departmental financial manuals provide a multitude of standards for processing of transactions, largely procedural, that are geared to operations and that vary across business lines. However, they are inconsistent, incomplete or silent with respect to input controls that impact on revenue reporting, for example, to ensure the accuracy and completeness of data input, or the time frames required to clear unprocessed inventory or to follow-up on outstanding items. While there will always be some tax dollars subject to allocation on the basis of formula or other proxy measure because of inherent time lags in the revenue reporting process — for example, between the time of deposits at banks and the time the information reaches Revenue Canada for processing — these need not be exacerbated by inefficiencies in departmental systems and practices. Of particular concern to us is the Customs system for processing deposits. As noted in paragraph 31.37, the Customs accounting system for deposits is a labour-intensive manual system. It is slow and prone to error. This system handles about \$18 billion in receipts yearly, the bulk of which is GST on imported goods. In recent years, much of the delay in finalizing year-end revenue numbers has been related to reconciling or correcting errors in the Customs accounting system.

31.48 Reconciliations. Reconciliations are detection controls that, if done appropriately and on a timely basis, will catch errors, omissions and misallocations in recorded amounts and flag them for the attention of management to take corrective measures. Conceptually, the process is not unlike reconciling one's own bank statements each month-end. It means ensuring that all deposits are recorded by the bank in the right amounts, that all cheques and

charges are appropriately processed and authorized and that one's own records of receipts and disbursements are complete and correspond accurately to those of the bank. It also means identifying any outstanding items and ensuring that they are accounted for in the monthly bank statements that follow, and that any errors are corrected on a timely basis. In our opinion, Revenue Canada does not perform all of the reconciliations that are needed for good financial management. Over the years, we have highlighted the need for the Department to ensure that appropriate reconciliations are performed regularly and on a timely basis, to minimize errors in financial reporting and to derive assurance that systems and controls over receipts, disbursements and record keeping are functioning as they should. Exhibit 31.7 provides an overview of the deposit and cheque issue process that impacts on the Department's reconciliation process.

Exhibit 31.7

(This exhibit is not available, see the Report)

31.49 Revenue Canada performs a number of matching processes and reconciliations to support the control, accounting and reporting of revenues and refunds. Nevertheless, two matters in particular cause us concern. The first deals with the completeness and timeliness of reconciling revenues received, and any offsetting payments and adjustments such as refunds and transfers, to amounts recorded in the central accounts — the government's official books of account — for subsequent reporting in *The Fiscal Monitor* and year-end financial statements. While significant improvements have been made in the quality and timeliness of the reconciliation process, we found that Revenue Canada has yet to fully reconcile all revenues, offsetting payments and adjustments to amounts in the central accounts on a regular and timely basis, and it attempts to fully reconcile only once during the year, typically at year-end.

31.50 The unreconciled amounts are significant both individually and in total. For example, while the Department advises that established policy is to have a number of checks and balances done locally to control the issuance of manual refund cheques, it does not do, at headquarters, a central reconciliation of all manually issued refund cheques; in 1996-97, \$1.6 billion of manually issued refund cheques were not reconciled to departmental records for year-end reporting. Nor does the Department fully reconcile deposits in the government's bank account to its own records of deposits in departmental systems. Again using 1996-97 as an example, three months after the year-end the Department reported to us that out of a yearly total of over \$200 billion in receipts, there was still \$34 million in bank deposits unmatched to deposits recorded in its systems and \$28 million in recorded deposits unmatched to bank deposits, for a potential net discrepancy of \$6 million. In previous years, the unreconciled differences for cash deposits at year-end were substantially higher. Regarding the matching of deposits, the Department's position is that timing differences — between the receipt of deposit information and the reporting of related information in departmental systems — is one of the major reasons it cannot reconcile fully even three months after year-end. It also states that reconciling all but a small percentage of revenues is sufficient. But a small percent on this one reconciliation alone amounts to tens of millions of dollars in unreconciled amounts. Moreover, we do not consider reasonable the Department's explanation for untimely and incomplete reconciling of amounts, for two reasons. First, the over \$200 billion in cash receipts for the year comprises only about 100,000 deposits, or an average of some 400 deposits each working day. Second, as noted in paragraph 31.37, much of the delay is due to inefficiencies in current systems, and in particular the Customs system, which accounts for \$18 billion in yearly tax receipts.

31.51 The foregoing provides two examples of a number of components missing from the Department's current reconciliation practices. The lack of a full reconciliation has implications for monthly reporting of revenues by stream, since hundreds of millions of dollars in monthly unmatched amounts get allocated among the various revenue streams using as a proxy measure a formula based on historic data. These amounts are not completely cleared up even after year-end. To the extent that the proxy measures are not in line with actual amounts, there will be inaccuracies in reporting throughout the year. In addition, these practices impact on trend analysis and on the credibility of the government's control over its finances. Moreover, the lack of full and timely reconciliation means that Revenue Canada is not in a position to provide complete assurance on the accuracy and completeness of the amounts by revenue stream for monthly and year-end external reporting, notwithstanding that it may have a strong sense of comfort that the revenues are reasonably well represented.

31.52 The other matter of concern to us is that the Department does not reconcile central account balances to its taxpayer records. The possibility therefore exists that certain adjustments, transfers, or cash transactions are not reflected appropriately in the revenue figures it reports. The importance of reconciling to taxpayer records is further highlighted by the fact that Finance and Administration does not have access to all adjustments that impact on revenue reporting. For example, the Department's taxpayer accounting systems automatically offset a taxpayer's credit balance with any liability balance for the same taxpayer. But the systems do not generate a summary listing to capture those transfers. Depending on the magnitude of these offsets, or other adjustments, this could impede the analysis of trends and variances in revenue amounts reported from one year to the next. Reconciling to taxpayer records provides the ultimate check that cash and revenues reported are complete and appropriately represented by revenue stream. From the perspective of financial control, reconciling taxpayer records to the assessing, collection and write-off systems would also provide assurance that these systems are operating as intended — for example, that all cash or remittance payments have been deposited or that no records of receivables have been lost. As noted, the Department is in the process of re-engineering its accounting systems over the next five years. In view of the importance of these reconciliations, it is essential for the Department to ensure that appropriate linkages to taxpayer accounts are designed into the new systems, that these are adequately tested before implementation, and that the reconciliation feature is instituted in tandem with each system release.

31.53 Revenue Canada should review its policies and ensure that appropriate, consistent and complete standards of performance are in place for revenue reporting across program branches, and should monitor adherence to those standards. It should ensure that headquarters is provided with more automated tools in support of revenue reporting activities and periodic and full reconciliations of revenue. As part of the re-engineering of accounting systems, the Department should ensure that reconciliations to taxpayer records are properly designed and instituted.

Department's response: Revenue Canada understands that this recommendation is based on the Auditor General's view that there are certain weaknesses in systems, standards of performance and reconciliations. The following addresses each of the three areas:

Standards of Performance: The Auditor General notes that much of the delay in finalizing year-end numbers has been related to reconciling or correcting errors in the Customs' accounting system. While Revenue Canada has made every effort to consistently meet the Receiver General timetable for completion of the final financial statements, the need to undertake work on the deposit processing systems in Customs' programs is recognized. Interim solutions to address the shortcomings are being examined, while longer-term solutions will be identified as part of the overall re-engineering initiative. The Department will continue to ensure the completeness and accuracy of revenue information for each accounting period and communicate such information to the Department of Finance as expeditiously as possible, as was the case for 1996-97.

Systems: Revenue Canada has recognized that some inefficiencies exist in current systems and these are being addressed as part of a major re-engineering initiative currently under way in the Department.

Reconciliations: The two examples of weaknesses in reconciliations relate to manually issued cheques and the matching of deposits to departmental records.

Procedures exist for local offices to control the issuance of manual refund cheques. These procedures are supplemented by central reconciliation at headquarters for the majority of manually issued cheques. The procedure for central reconciliation for the remainder will be established in 1997-98.

With respect to deposits, at the time final financial statements were prepared, Revenue Canada had matched all but \$6 million out of the more than \$200 billion deposited during the year. This unmatched amount has since been reduced to just over \$2 million by the ongoing matching process and is expected to be further reduced as regional offices continue to provide supplemental confirming data. It should be noted that the majority of unmatched

deposits are generally the result of unrecorded foreign exchange and keying errors. The Department is examining systems improvements that will minimize such occurrences.

As part of the current re-engineering initiative, new interfaces to all existing revenue lines, with appropriate financial and systems controls, are being built and tested. Accordingly, links from all assessing and post-assessing transactions to the new Revenue Ledger will provide assurances that information is correctly passed from one system to another, thereby facilitating the reconciliation processes.

31.54 Analysis. Although recognizing that improvements have been made over the past two years, the Department of Finance has informed us that more analyses and more timely analyses are needed from Revenue Canada to ensure the reasonableness of month-end and year-end revenue numbers provided for external reporting, and to indicate relevant factors that explain period-to-period fluctuations under the current cash basis of accounting. For example, it expects Revenue Canada to be in a position to assess the impact of administrative, technical, and remittance regulations on the monthly and year-end revenue reports on a proactive basis — prior to the release of these figures. This would include, for example, knowing the impact of delays in batch entries, unprocessed claims, returns and refunds, and of changes in remittance and refund patterns for key taxpayers.

31.55 Revenue Canada informed us that both Finance and Administration and program branches have responsibility for analyzing the reasonableness of revenue reports under the cash basis of accounting. Finance and Administration at headquarters has a more limited role in this area, since revenue details are found in the feeder systems. In our discussions with program branches, it was not evident that there were any standards in place pertaining to the nature of routine analyses to be performed and the frequency of such analyses, or to the kind of information that would need to be considered, as a minimum, when analyzing the reasonableness of period-to-period revenue numbers for financial reporting purposes. We also found that program branches are not provided with any parameters on what constitutes significant period-to-period fluctuations requiring prompt investigative action. For the most part, program branches react to queries from headquarters or the Department of Finance, usually following the release of revenue figures, rather than proactively seeking out information to assure themselves of the reasonableness of revenue reports from period to period prior to their release. In this regard, we believe the Department could routinely analyze some key volumetric information that under a cash basis of accounting would result in a better understanding of the reasonableness of revenue fluctuations. For example, large taxpayers not filing remittances on time could account for big swings in period-to-period amounts reported for some revenue lines, and these could be identified regularly before the release of interim revenue reports. We note that Finance and Administration at headquarters is looking at doing more revenue analysis.

31.56 Along with the lack of specific departmental guidance from Revenue Canada on analyses in support of revenues being reported, we also noted that the Department of Finance does not provide Revenue Canada with any criteria on the degree of accuracy required by revenue stream for reporting in *The Fiscal Monitor* and in the Public Accounts. While terms of reference between Finance and Revenue Canada do exist for revenue reporting matters, they are expressed in broad terms, focussing on roles and responsibilities, and are void of any specific guidance on what would constitute a significant distortion in each revenue stream. Nor is there any communication of assumptions implicit in revenue forecasts. This is information that could assist Revenue Canada in dealing with interim or year-end reporting issues. It would also provide a better context to assess period-to-period revenue reports for reasonableness and potential distortions.

31.57 As part of our audit, we considered queries about revenue fluctuations raised by Finance for follow-up by Revenue Canada. We found that most queries related to specific bookkeeping issues, some of which were addressed on a more timely basis than others. However, in one particular case, after considerable delay and despite a number of requests from Finance for volumetric information on the stock of unprocessed GST credit claims each reporting period, Revenue Canada is only now beginning to address the issue. It did not respond earlier because one of the key program branches responsible for this information gave it a lower level of attention.

31.58 The issue of GST fluctuations is an important one for financial reporting purposes. As shown in Exhibit 31.8, the monthly revenues have fluctuated significantly over time and with no apparent pattern. In addition, GST revenue for 1995-96 unexpectedly decreased by \$400 million from 1994-95. We feel that Revenue Canada and Finance together ought to be able to understand and explain such fluctuations, which may be the result of many factors (the volume in unprocessed GST credit returns and GST claims at the end of a reporting period may be one factor). Chapter 32 of this Report focusses on the two departments' analysis of the \$400 million decrease and recommends ways in which the departments' analytic capability could be strengthened.

Exhibit 31.8

(This exhibit is not available, see the Report)

31.59 Over the past two years, an interdepartmental Fiscal Monitor Committee with representatives from both Revenue Canada and Finance has been established to help deal with reporting issues. Since the fall of 1996, the meetings have been more structured and formalized. According to both Revenue Canada and Finance, they are providing a good forum for dealing with issues and for understanding respective needs and constraints. It is largely through this forum that questions on revenue fluctuations get raised by Finance for Revenue Canada's analysis or follow-up. Nevertheless, Finance would like Revenue Canada to do more independent analysis and, in response to queries raised, more timely analyses.

31.60 Revenue Canada should clarify its expectations of program branches for analyses relating to the monthly revenue reports, and provide criteria for thresholds that would prompt investigative action.

Department's response: As noted by the Auditor General, the interdepartmental Fiscal Monitor Committee is providing a good forum for dealing with analysis issues. However, it is often difficult to identify thresholds that would prompt investigative action, since there are many reasons why a variance might occur. The installation of thresholds would not, in all cases, identify instances where investigative action is called for. However, Revenue Canada, in concert with the Department of Finance, will continue to develop specific performance measures that prompt investigative action and report on them regularly.

31.61 For revenue reporting matters, the Department of Finance should specify required levels of precision by stream of revenue, and equip Revenue Canada with information on economic assumptions implicit in revenue forecasts.

Department of Finance's response: The Department of Finance will continue to work closely with Revenue Canada in the analysis of monthly tax collections.

Excluding revenue reporting, stakeholder information needs are largely met

31.62 Beyond revenue reporting, Revenue Canada is relied upon to provide accurate, reliable and timely information to many stakeholders. We wanted to see if other major stakeholders' needs were being met. We considered the Tax Policy Branch within the Department of Finance, some areas of Trade Statistics, Business Sectors and socio-economic areas in Statistics Canada, and the Treasury and Accounting section of the Receiver General of Canada.

31.63 The Tax Policy Branch needs accurate and complete information on revenue programs to assess the workings of the current taxation system and to be able to determine the possible impact of future tax measures. We found that, generally, the reliability of the data meets the needs of the Branch. However, there are issues still to be resolved concerning the timeliness, sufficiency and availability of certain revenue data. Both departments have discussed these issues, some temporary measures are being worked out, and a memorandum of understanding (MOU) may be negotiated on these matters. A separate interdepartmental committee representing both Finance and

Revenue Canada has been established to deal with tax policy matters and issues. Meetings of this committee provide another good forum for dealing with respective needs and constraints.

31.64 Revenue Canada provides Statistics Canada with information on individual and corporate taxpayers, trade of goods, and traveller entry. Revenue Canada has negotiated a number of MOUs with Statistics Canada to facilitate the transfer of data, clarify terms of reference and ensure that confidentiality provisions are upheld. Officials from the major program areas at Statistics Canada who receive information told us that they are generally satisfied with the timeliness and quality of the data and have maintained frequent contact with Revenue Canada liaison personnel.

31.65 The Receiver General provides the banking facilities to support the deposit function and manages the reporting of Revenue Canada's departmental financial figures. Receiver General officials noted that Revenue Canada's monthly accounting for its cash deposits often extended several days beyond the deadlines established for each month-end. Overall, officials noted improvements in the timeliness of accounting for cash deposits in the last three years.

Key Central Administrative Functions

31.66 In addition to looking at the Department's performance in two key areas of fiduciary responsibility, we examined the central administrative functions that underpin any financial management regime aimed at ensuring the orderly, efficient and effective conduct of business affairs, namely: planning, funding, budgeting, performance monitoring, reporting, and holding managers to account for results achieved.

Department-wide, planning processes are sound and still evolving

31.67 We looked at the Department's strategic and current-year planning at both the corporate and the operational levels. We assessed the way the Department defines its long-term and short-term plans and commitments and the way it makes these commitments known in the field. We also examined the processes designed to hold managers to account. Our focus for much of the planning work was on the Department's Business Plans.

31.68 For the period under review, Revenue Canada has been proactive in formalizing its corporate strategies and directions for the future, encouraging more regional participation in the planning process and communicating plans and intentions to the field.

31.69 In keeping with its strategic objectives, the Department has held regular planning and priority-setting meetings, both at the corporate level among senior management and between program branch managers and regional operations in each of the Department's lines of business. These initiatives were said to have resulted in a better understanding of the priorities and constraints facing the Department and of the deliverables expected from operations. Recently, the Department reorganized its senior management committee structure to further promote the sharing of key management concepts and best practices in its diverse mandate, and to identify ways of better ensuring a horizontal and co-ordinated approach to managing overall operations.

Plans reflect government objectives and priorities

31.70 We reviewed the 1995-96 and 1996-97 Business Plans against the 1996-97 Part III Estimates and the federal Budgets for the last five years, and against the Department's Outlook, Planning and Update documents and Performance Reports that it tabled in Parliament in 1996-97.

31.71 The results of our review were generally positive. We found that the documents appropriately reflected the government's priorities and the challenges facing the Department. We also found that the Updates and the Performance Reports were generally linked to the Outlook and Planning documents.

31.72 Program branches have begun to develop their own strategic and current-year plans from the corporate plans. Current-year plans include budget, resource and workload considerations. In addition, management contracts are emerging that further devolve responsibility and accountability to the field, reflect branch objectives and priorities, and are meant to strengthen managers' accountability. Although they are evolving, and are at different levels of refinement among business lines, generally the agreements communicate priorities and responsibilities for managers and define expectations for deliverables more specifically, either qualitatively or quantitatively — in the latter case, mostly in the form of information to be collected on a wide range of volumetrics or outputs (for example, number of seizures at borders, number of returns processed). We also noted a few measures expressed in terms of outcomes or emerging target outcomes. For example, we observed targets for the collection of tax debts.

31.73 We acknowledge that tracking outputs is important for an organization such as Revenue Canada; they provide some measure of productivity. In our view, outputs and targets taken together in the context of outcomes to be achieved would constitute more appropriate results-oriented deliverables against which to assess actual performance. The initiatives taken in this area by some programs are encouraging. Chapter 11 of our October 1997 Report presents one such initiative by Customs for its Travellers Program. Customs has recently established several outcome targets such as those for traveller compliance by region, together with output targets for the number of inspections to be conducted. The outcome targets are expressed as the expected percentage of travellers at ports of entry who voluntarily comply with laws for entry into Canada. Customs has also taken steps to measure and report on actual performance against planned target outcomes.

31.74 In addition to defining more results-oriented deliverables, for planning it is important to also establish target costs for the results expected, and to ensure that the results are, in fact, measured and costed. During our audit we found that for many aspects of management contracts, actual costs for each specific deliverable would be difficult to determine. The focus of much of our review was on management agreements covering the 1996-97 fiscal year. We did not review the extent to which performance against deliverables was measured, since this information as well was not readily available. As noted, management contracts are still evolving. On the whole, we support these initiatives — not only because they begin the process to clarify performance expectations but also because the attendant reviews and discussions help to establish a common vision. However, we think more emphasis needs to be placed on cost considerations.

31.75 **The Department should expand the use of management contracts and ensure that they provide targets for deliverables in measurable terms together with expected costs to achieve them. Monitoring of performance against plans and cost targets should be enhanced and the results used to hold managers to account.**

Department's response: The Department recognizes the benefit of management contracts to establish performance expectations and lines of accountability. Indeed, management contracts have been in use in a variety of forms, in various headquarters program areas for several years. In 1996-97, contracts were expanded to headquarters functional authorities and the regions. Customs, for example, makes effective use of headquarters-regional accountability contracts to establish targets and monitor performance. The contracts set out clearly the program objectives, program delivery expectations and the allocation of resources to achieve results.

The contracts constitute a key component of the Department's overall accountability regime and also serve as a reference point for both program and corporate reporting. The use of such contracts is evolving and managers are encouraged to include in the contracts targets for deliverables in measurable and meaningful terms and link these to costs.

The various levels of accountability resulting from these contracts are reflected and tracked through the Department's management monitoring and reporting systems for both internal and external use. For example, at the business line level, the Department includes program accountabilities and results commitments in the Report on Plans and Priorities (Part III of the Estimates) and provides actual results in its Fall Performance Report. Considerable progress has been made in this regard.

Revenue Canada remains committed to expanding the use of management contracts and related accountability mechanisms and to monitoring performance against them.

Department's annual funding cut by \$300 million

31.76 Government restraint initiatives have resulted in significant multi-year cuts to the Department's annual resource levels for regular workload. In total, by 1998-99 these will amount to \$300 million annually, representing a reduction of 14 percent from 1994-95, to continue indefinitely thereafter (see Exhibit 31.9).

31.77 The Department used its 1995-96 and 1996-97 Business Plans to alert decision makers to the potential impact that further cuts would have on its ability to maintain the integrity of its programs, and provided its strategy for managing with declining resource levels. Its strategy, as it had also outlined to the Standing Committee on Finance, was:

- to concentrate reductions in administrative and program support areas;
- to offset reductions with savings expected from the administrative consolidation of the two former revenue departments and a wide range of business process re-engineering initiatives; and
- to request resources from the Treasury Board for any new work (for example, new government priorities, tax policy initiatives, volume growth).

31.78 Underpinning this strategy was a judgment call on the minimum level of resources needed to maintain the integrity of programs, taking into account the benefits expected from initiatives, which were also based on value judgments. Revenue Canada also made a commitment to constantly monitor the funding situation and advise the government and Parliament accordingly.

31.79 The Department informed us that in keeping with its strategy, it has assigned the majority of its cuts to administrative and program support areas, as well as to more process-oriented activities where it thought the benefits of re-engineering initiatives and the application of technology would be maximized.

31.80 In June 1996, senior management established a Project Review Committee that was tasked to assign re-engineering project priorities and oversee their progress to implementation. A central fund of \$83 million over three years, subsequently increased to \$128 million, was established to help program branches defray their associated costs. Before June 1996, key re-engineering projects were reviewed centrally for decisions on funding but were not subject to any independent, systematic monitoring or scrutiny before implementation.

31.81 We were interested in knowing which of the Department's wide range of business process re-engineering initiatives were critical to offset the effects of funding costs in the future, and how the related actual benefits/savings were being tracked and the effects monitored Department-wide. We were also interested in how the Department assured itself of "not compromising program integrity" across the business lines in this period of declining resources.

31.82 The Department indicated that many of the expected savings from key re-engineering efforts will begin to materialize only in future years. It notes that the cumulative impact of the cuts, combined with other changes affecting the Department's budget or program priorities, is under continuous review by senior management through a number of forums where funding issues can be raised, including the Project Review Committee, the Priorities Committee and the full Departmental Management Committee. It further states that most funding issues are dealt with internally and, where absolutely necessary, referred to the Treasury Board. We encourage the Department to maintain its effort to ensure that reductions are achieved in the targeted areas and do not compromise the integrity of essential programs.

31.83 External funding. Revenue Canada uses business cases to support its requests to Treasury Board for approval of additional funding for new work, which includes volume growth or new projects. In 1995-96 and 1996-97, the Department's additional funding requests for new work amounted to over \$1.3 billion to meet its needs until 1999-2000. It received approval for about \$970 million; some of these approvals were added to the base level to continue indefinitely. Exhibits 31.9 and 31.10 provide additional contextual information on the amounts requested and approved for the five years, using the 1994-95 funding levels as the reference point. In particular, they show that prior to Program Review reductions, Revenue Canada would have been allocated some \$11 billion to fund regular workload during the five-year period, but subsequently had to absorb about \$1 billion in spending reductions from that level. Over the same period it received a total of about \$1.4 billion for new work: the \$970 million referred to above in approved business case submissions, and a further \$430 million for adjustments needed to account for such things as programs transferred to Revenue Canada from other government departments. All business cases are initially prepared by program branches and then are reviewed by Finance and Administration at headquarters, for objective challenge by an analyst. Once through this process and approved, the business cases are sent to the Deputy Minister for recommendation and ministerial approval and then submitted to the Treasury Board.

Exhibit 31.9

(This exhibit is not available, see the Report)

Exhibit 31.10

(This exhibit is not available, see the Report)

31.84 Business cases are integral to the Department's process for obtaining funding for new work. We reviewed 30 business cases, out of a total of 52 covering the 1996 and 1997 fiscal years. We selected eight for detailed examination.

31.85 We found that all the cases we reviewed were qualitatively sound, in that they included, for example, background information, the justification for the request, and the projected impact if the resources were not secured. Some of the cases relied on regression analysis to predict growth patterns, while others used weighted averages; the approach depended on the nature of the operation being costed. We found the approaches used to be generally appropriate. In the cases that had multi-year funding implications, we noted that the assumptions forming the basis of the multi-year estimates were consistent from year to year. We are generally satisfied with the supporting documentation used and the challenge offered by the analysts, except as noted in the following paragraphs. In particular, we found that more rigorous quantitative challenge of business cases is needed as well as a system to monitor the use of funds and associated results received for specific purposes.

31.86 Accounting for specific-purpose funds. Revenue Canada devotes considerable effort to preparing business plans in support of additional funding for new work. Once the funds are received they are rolled into the Department's overall budget. Unless required by the Treasury Board, it does not track separately the use of resources and associated results made available for specific purposes. The Department's position is that while it considers it has the capacity to track both the use and associated results of specified funds, it chooses not to on grounds of cost/benefits. Moreover, it believes it has the flexibility to reallocate funds received based on emerging priorities. It also has stated that some projects or activities are more amenable to tracking than others. For example, accounting for incremental growth would be more difficult since the impacts are spread across the Department.

31.87 While we agree that some projects or activities may be easier to track and monitor than others, in our view the complexity of doing so, or the absence of specific directives from central agencies to do so, does not mean that management should not have assurance that the funds are generally being used for their intended purposes. In view of the approval that Revenue Canada has received of sizeable funding for new work or specified initiatives (as noted, cumulatively about a billion dollars in the last year and extending for the next several years), in our opinion at least some analysis at an appropriate time of the use of additional funds and results achieved against assumptions and objectives in the underlying business plans is needed for accountability purposes. Results from the analysis would then feed into the process for preparing, challenging and approving future business plans — for instance, on the reasonableness of assumptions used and associated cost considerations. This information would also serve to hold managers to account.

31.88 Need for more rigorous quantitative challenge. We found calculation errors or an absence of substantiating information in three of the eight funding requests we reviewed in detail; in two of the cases, the combined calculation errors resulted in approval of excess funding to the Department of \$700,000 - \$164,000 of which extends annually for an indefinite period. In the third case, a portion of the requested resources, amounting to \$1 million (also for an indefinite period), was inadequately substantiated.

31.89 The Department has not been consistent in accounting for the effects of re-engineering or other efficiencies on anticipated costs of new initiatives. For example, another case we reviewed involved a request for \$59 million over three years to handle projected increases in the volume of individual and corporate tax returns and payment processing. The Department used existing productivity rates to calculate the amount requested, but did not consider the anticipated increased efficiency and therefore the lower costs expected from the introduction of automated scanning technology. By contrast, in another case, in estimating the resources required to deal with GST registrants who do not file their returns, the Department factored in the savings that would flow from a re-engineered collection process. In so doing, it improved the accuracy of its cost estimate and reduced its funding request by more than \$4 million (17 percent of the amount requested). The need to consider and scrutinize the effects of re-engineering and other business process initiatives when estimating costs in funding requests is obvious. These need to be looked at more closely through the challenge process.

31.90 The Department should consider the effects of re-engineering and other business process initiatives in estimating costs, to support funding requests to the Treasury Board. Revenue Canada should subject business cases to more quantitative objective challenge. It should, at an appropriate time, analyze the use of funds received for specific purposes, consider the information in preparing future funding requests, and hold managers to account.

Department's response: Revenue Canada agrees that the effects of re-engineering and other initiatives should be considered in estimating costs to support funding requests to the Treasury Board.

In fact, this is done on a regular and consistent basis, by the Department's financial management and accounting functions. However, this can be carried out effectively for new projects only when the anticipated benefits, including savings, have been realized or are expected to be realized.

Departmental managers at all levels of the organization are held fully accountable for the management and use of resources, and the results to be achieved. This is assured through regular monitoring at meetings of the senior Departmental Management Committee.

The Department also fully accounts for its use of resources and results achieved, through regular reporting to Parliament in its annual Report on Plans and Priorities and subsequent Performance Report.

Deficiencies exist in budgeting and cost systems

31.91 Managers in the field reported that they understood the budget allocation process fairly well, that the annual call letter documentation was adequate and that they had an opportunity to discuss resource levels with program and regional managers and make known their views on the pressures resulting from budget cuts.

31.92 Managers enter their budget information in a centralized national budget system. Common complaints are that this system is over 20 years old and difficult to use in reconciling total activity hours with the activity management system. It also has limited budgeting options, so some managers do not bother to enter all the details on overhead (indirect codes). Specialized reports take a long time to be produced, and the user manual is out-of-date. Our observations about the system confirm that the current design does not provide useful, relevant cost information on individual projects that cut across responsibility centres in the various lines of business, and it hampers the ability of managers to optimize the use of resources. For example, during our audit we became aware of a situation in which resource management staff, even after about two months and numerous requests across the Department, were still unable to provide overall cost-to-budget statistics on a re-engineering project that had just been completed. Similarly, the Department cannot get accurate information on actual costs in relation to budget estimates for a re-engineering project currently under way, valued at an estimated \$78 million.

31.93 As with the budgeting systems, we found that the support systems used to track production (hours and related dollars) and expenditure data were over 20 years old, were cumbersome to use, did not provide timely information and had been modified in haste to meet administrative consolidation needs. Customs and Trade Administration stated that the systems did not meet many of its needs. Similar observations were raised by many officials across the lines of business. We also observed the use of proxy measures when determining the ceiling for payment of costs associated with a particular partnership agreement. The Department has documented many of these long-standing problems in data quality and system inefficiency and is in the process of completing specifications for the replacement of administrative support systems, but the earliest date for delivery is April 1999.

31.94 **When completing the specifications for its new systems, the Department should ensure the capture of complete, timely, relevant program production and expenditure costs.**

Department's response: Revenue Canada will endeavour to develop as comprehensive a set of specifications as possible for its net systems, in order to improve accessibility, timeliness, and the amount of information provided.

Need for more outcome-oriented performance monitoring tied to corporate objectives

31.95 For the period under review, we wanted to know the extent to which program branch and regional management were fully aware of the results they were expected to achieve, the extent to which program results were linked to corporate objectives and communicated to senior management, and the extent to which program branches were appropriately tracking and reporting the cost of delivery through adequate cost support systems.

31.96 At Revenue Canada, management committees review program direction and performance. Strategic program goals and priorities are set both by the Departmental Management Committee and bilaterally by the Deputy Minister and assistant deputy ministers. Program branches bring forward performance information to the Departmental Management Committee to report on results being achieved, many in the form of operational outputs and a few in the form of outcomes achieved against pre-established target outcomes. We observed that while the Department has defined a number of strategic goals, work is needed to transform more of these goals into target outcomes and to define the appropriate measures against which to assess performance. While most performance measures are decided by the program branches, we have been informed that a number have also been set by the Departmental Management Committee and the Deputy Minister. Recently, Revenue Canada has begun using standing agendas to review program branch performance on a periodic basis. It has indicated that the Departmental Management Committee provides an effective forum for challenging reports on performance and that this process

also impacts on the performance measures being used. We encourage the Department to continue its efforts in this area, and to expand its current challenge process to ensure that appropriate target outcomes and outputs are established in line with corporate objectives and strategic goals, that the indicators of performance used are the correct ones, and that they are reviewed periodically by senior management for relevancy.

31.97 We found that management at headquarters and in the regions had good knowledge of the resources made available to program branches and regional operations to deliver services, and had knowledge of the outputs they were expected to deliver. As noted earlier, some program branches have begun to provide information on target outcomes together with critical measures of success for field operations, but these were in the initial stages of development.

31.98 **The Department should expand its challenge process to ensure that appropriate target outcomes and outputs are established for program and regional operations in line with corporate objectives and strategic goals, and that indicators of performance used are the appropriate ones. It should review these periodically to ensure that they remain relevant.**

Department's response: As one of the original six pilot departments, Revenue Canada participated in the Improved Reporting to Parliament Project, by preparing revised Estimates documents focussing on planning and performance information, with a renewed emphasis on results management.

Through its continued participation in the pilot project, the Department remains committed to improving performance measurement reporting. The Department will continue to work closely with central agencies and the Department of Finance in the further development of appropriate performance indicators for all its business lines.

The Department is also active in developing service standards. Fifteen service standards for major external services such as Rulings on Technical Income Tax Law Interpretations, Enquiries Programs and Processing Services have been developed, with an additional 17 planned for completion by the end of 1997.

Poor generation of information to support decisions

31.99 Departmental officials reported that many program systems were inefficient for decision-making purposes, since the information was "locked" in old systems not initially designed for this purpose and they often provided fragmented information. These difficulties are impediments to reporting by the program branches on the attainment of a number of program objectives. We reviewed the content of 106 items in the 1996 Performance Report and found that the information came from over 30 different systems; about 55 percent of the items had to be manually generated since the information was not readily available in formal systems. Some of these items were tied to studies to generate specific performance information. However, others had to be manually generated because of disconnected systems, or systems not moving as fast as needed to provide the required information. We noted that many of the items were of a volumetric nature, presented without targets that would offer a context to assess performance. Some information items could not be supported, since they had been generated at a specific moment and could not be replicated. Because of the disconnectivity of systems, the information used for performance is not readily available to all, and so it is difficult to monitor overall performance nationally.

31.100 In addition, in interviews with departmental officials, many indicated that it usually takes from four to eight weeks to obtain from systems even simple ad hoc data extractions that have not been previously requested. Where the requests involve complex data manipulations and analytical information to satisfy internal user needs, the turnaround time is said to be much longer, entailing many months as opposed to weeks. We noted recurring cases where these complex requests had to be redone because of erroneous initial processing linked to definitional problems in data selection or to systems complexities. One program branch has initiated a pilot "data warehouse" project in an effort to address existing systems shortcomings, in order to allow for timely, flexible access to data needed to manage program operations effectively. However, this does not solve immediate problems, nor does it

respond to needs across all business lines. This is worrisome since Revenue Canada is accelerating its shift to an information-based organization, becoming increasingly reliant on diverse forms of information to ensure that scarce resources are deployed where risks are greatest.

31.101 Our audit revealed that the concept of system ownership was not well understood by some program managers, most of whom assumed the reliability of the data in the systems. Management has not independently validated the quality of the data as the systems have evolved through the years. Program analysts reported having to independently clean and purify the data in some systems, which was difficult and time-consuming.

31.102 The Department should ensure, and periodically review, the integrity of information in its systems.

Department's response: The Department recognizes fully the importance both of overall systems integrity and of the accuracy and reliability of the information in its systems, and conducts some reviews and assessments of the information contained in its automated systems.

For example, in the Customs program, the concept of system ownership and responsibility for the integrity of information in those systems is generally understood and accepted by program managers. Moreover, there are automated validation processes in place, complemented by monitoring procedures to ensure the ongoing operational integrity of systems and the quality of data being stored.

Similarly, within the Department's verification and enforcement function, specific program and technology support functions are dedicated to the monitoring and review of the integrity of data in custodial information systems. Data validation and error reporting are undertaken on a regular basis to monitor the accuracy and quality of data input by field staff. In addition, regular meetings of headquarters, regional and field staff are held to ensure that follow-up action is taken where necessary and that the integrity of data is maintained.

Financial Management Environment

31.103 The third part of our audit looked at Revenue Canada's broad approach to managing financial management organization-wide. We considered the organization and priorities of the Department and how these affect its financial management systems.

Systems and technology are a crucial duo for Revenue Canada

31.104 Systems and technology are among the most important tools Revenue Canada has at its disposal to deliver its mandate. They underpin virtually every activity or operation the Department administers, and provide the means by which Revenue Canada can deal with tens of millions of diverse transactions each year, efficiently and at a much-reduced cost.

31.105 The results of our audit indicate overwhelmingly that many of the Department's formal systems are weak, particularly in the areas of cash management, revenue reporting, performance monitoring, containing financial risks, and ensuring that resources are used effectively and efficiently. Several of the systems are old in design, labour-intensive, slow to generate information, or very inefficient. The information they provide is typically fragmented and, in many instances, not the type of information management needs.

31.106 Management relies on proxy measures, informal information systems and other bridging practices to compensate for the shortcomings of the formal systems.

Meeting basic legal requirements and government initiatives are top departmental priorities

31.107 The Department's top priorities are to meet legislative requirements and support government-wide initiatives. Financial management must support the Department's efforts to achieve the government's stated overall intentions and priorities and to ensure that the laws, as they affect Revenue Canada, are complied with.

31.108 Meeting these obligatory priorities year in and year out is a complex undertaking. In addition to complying with financial laws and executive authorities, Revenue Canada must also ensure that its assessing systems and delivery programs reflect any new legislative measures that impact on the collection of income tax, GST, customs or excise duties and levies, as well as any social or economic benefits administered through the tax system. Similarly, the Department must also take into account any provincial requirements that, through partnering arrangements, are administered through the federal tax system.

31.109 Departmental officials inform us that changes in requirements rooted in federal or provincial tax legislation alone typically translate into tens of thousands of programming refinements to assessing systems each year. Revenue Canada often has only very short lead times in which to institute such changes to meet statutory deadlines, even when they entail the introduction of major new programs.

31.110 The introduction of GST credits in 1990 and child tax benefits in 1993 are two good examples. From the time of the respective Budget announcements, Revenue Canada had less than a year to implement the systems and procedures to deliver the Child Tax Benefit Program, and less than 20 months to implement the systems and procedures to support the entirely new GST and related GST credits. This placed considerable pressures not only on existing departmental systems and on the creation of new ones but also on the delivery of programs to facilitate taxpayers' compliance with new legislative requirements.

Financial management competes with other priorities

31.111 During our audit, senior officials indicated that meeting legislative requirements and government-wide initiatives was their first priority. The second priority was dealing with matters impacting directly on taxpayers accounts, records and benefits. Third was dealing with re-engineering initiatives to streamline business operations and make them more cost-efficient, and maximizing the benefits of administrative consolidation by integrating data for the benefit of management and taxpayers. A distant fourth, given the pressures already placed on existing systems and practices to meet ongoing commitments, was to deal with internal needs or improve the management of programs and operations. The correction of shortcomings in formal systems depends either on the Department's priorities for systems work or on the priorities established within business lines for financial management matters in general.

31.112 The Department has a generally impressive track record of developing systems to meet basic legal requirements in programs and operations that involve collection or disbursement of billions of dollars and to deliver on government-wide initiatives. As noted, these achievements represent a significant challenge and require a concerted departmental effort, often not without compromise. Compromises have typically translated into shortcomings surrounding financial management requirements that are more discretionary.

31.113 Our audits in the Department over the past few years have noted some pertinent examples of compromises impacting on financial management in several programs. For example, in 1996 we looked at the administration of child tax benefits and GST credits, an \$8 billion-a-year operation. We concluded that while basic legal requirements were met, a number of fundamental checks and balances were lacking; as a result, financial risks could be significant. From 1993 to 1995, we looked at the regimes for collecting income tax debts and GST debts, the Department's management of the Scientific Research and Experimental Development program, the new regime for processing individual income tax returns, and the Non-filers and Special Investigations programs, among others. Those audits found several deficiencies in financial management, for example:

- ineffective risk–scoring systems to minimize revenue losses;
- problems with data integrity in management information systems maintained for certain programs;
- the reporting of insufficient or inaccurate financial management information that impacted on the management of the government’s finances;
- inadequate analysis of information being generated;
- erroneous or untimely program statistics meant for monitoring purposes;
- insufficient or inadequate analysis of financial and operational results; and
- a need for better accountability and results–oriented information.

31.114 As noted in paragraph 31.16, the Department is making satisfactory progress in dealing with several of our observations. Some shortcomings remain and are starting to have a multiplier effect. Clearly, it is important that the Department maintain the momentum of ongoing corrective actions and give appropriate priority and attention to correcting remaining deficiencies.

31.115 A case in point is the new regime for processing individual tax returns. We note that five years after the launch of the new regime, systems and practices to contain financial risks still have significant deficiencies. As discussed in October 1997 Chapter 18, Revenue Canada has made strides in purifying data that are essential to analyze the trends in non–compliance of returns and the effectiveness of scoring routines to contain financial risks. However, it has done only limited analysis of these data in an effort to understand and address problems with non–compliant reporting. Several of the federal government’s social programs are linked to an individual’s assessment of net income for tax purposes. Errors in individual returns, therefore, also impact on entitlements to social benefits, both federal and provincial.

31.116 The potential effects on the public purse are substantial. For the 1993 tax year, for example, using the results of its random samples on 16 deduction or credit line items, the Department estimated that the total net tax recoverable for the entire population of returns would amount to \$181 million. Beyond compiling this aggregate statistic, however, Revenue Canada did not perform any further financial analysis to determine how much of the net projected amount it could reasonably expect to collect, or how best to deploy resources to maximize revenue generation and encourage compliance in reporting.

31.117 At the conclusion of our audit, the Department had not completed its projection of net recoverable amounts following the results of its random samples for the 1994 and 1995 tax years. How these compare with the 1993 aggregate statistic remains to be determined. The lag in compiling these aggregate statistics, coupled with the lack to date of any substantive analysis of compliance data on hand, indicate that financial management needs attention, given the potential amount of revenue involved.

Organizational responsibility for financial management is shared and decentralized

31.118 Financial management at Revenue Canada cuts across every line of business and is part of every program (see Exhibit 31.11). It is not a separate system or a separate function, but is integral to almost every operation. Within each line of business, there are several program branches that provide functional and line direction, with regional operations deciding the method of delivery of programs. Headquarters deals with internal administrative matters and is responsible for managing many of the Department’s fiduciary responsibilities. Exhibit 31.12 illustrates the organization of Revenue Canada and the existing reporting relationships.

Revenue Canada's Business Lines

- Assistance to Clients and Assessment of Returns
- Customs Border and Trade Administration Services
- Verification and Enforcement
- Revenue Collections
- Appeals
- Administration and Information Technology

Source: Revenue Canada - 1996-1997 Part III Estimates

Exhibit 31.12

(This exhibit is not available, see the Report)

31.119 Responsibility for financial management is shared and decentralized among headquarters, program branches and regional operations. Business lines are the responsibility of program branches and regional assistant deputy ministers, who determine their own financial management systems and practices for their respective areas of responsibility. Headquarters determines the systems and practices for corporate-level management of resources and expenditures, and assesses overall funding requirements and strategies. Headquarters, program branches, and regional operations all share in maintaining books of account and subsidiary records as well as other necessary records for reporting to Parliament and other stakeholders.

31.120 The shared and decentralized financial management framework requires clear responsibilities, accountabilities and minimum fiduciary expectations. Lines of business are diverse, as are the various programs operating within them. No single formula is possible for financial management across the organization. This requires functional guidance and standards and an overall review and co-ordination of financial management practices and systems. We observed that this was not being done.

31.121 We noted that the Department has started to review the mandate of the internal audit function with a view to making it more independent and effective. However, for the period covered by our audit we found that internal audit had not been used effectively to provide overall assurance on the state of financial management corporate-wide. Its work was generally negotiated with program and regional assistant deputy ministers, who had the final say on the scope, nature and rigour of reviews to be undertaken. This impacted on the quality of the work internal auditors could do and the level of independence they had in setting the audit scope.

31.122 Revenue Canada should strengthen the role of internal audit so that it can provide senior management with independent assurance on the state of financial management in the Department.

Department's response: A number of enhancements to the Department's review function (Internal Audit and Program Evaluation programs) are currently under way, including:

- *establishment of a Senior Audit Committee (the Departmental Priorities Committee);*
- *the development and installation of new, comprehensive policies for both Internal Audit and Program Evaluation;*

- *planned modifications to reporting and follow-up formats and follow-up processes; and*
- *improvements to the Internal Audit and Program Evaluation planning process.*

Collectively, these changes should significantly improve the Department's capacity to utilize the internal audit function, and more effectively provide an enhanced review and assurance capacity to the Department's financial management regime.

Conclusion

31.123 Revenue Canada has gone through a period of tremendous change, both organizational and legislative. Nevertheless, we found senior management quite cognizant of its responsibilities for financial management.

31.124 Our examination revealed some areas of strength, no areas of neglect, but several areas in need of improvement. Many bridging practices in the form of proxy measures, informal information systems, internal consultations, or reliance largely on the judgment and experience of individual managers have emerged across the organization and have helped reduce some of the risks — but basic shortcomings remain. While the use of such means to provide comfort on financial management issues may be acceptable in some limited circumstances, such an approach on an ongoing basis entails substantial potential financial risks.

31.125 We observed that much of the responsibility for minimizing financial risks and protecting financial assets lies with the program branches. Our audits in previous years have dealt with aspects of financial management within specific programs, noting that improvements were needed in several areas. We are generally satisfied with the Department's actions taken to date in dealing with our previous recommendations, but more remains to be done. The Department needs to sustain its momentum to resolve matters still outstanding.

31.126 We also noted that opportunities exist to improve performance in cash management across all business lines. Our analysis shows that while the vast majority of remittances are deposited by next business day, performance is uneven and is costing the government several millions of dollars in forgone interest revenue. We also found that the Department needs to exercise more rigour in quantitative objective challenge of business cases supporting its requests for new funding.

31.127 Regarding those aspects of financial management that typically support management in achieving program objectives in an efficient and cost-effective manner, we found that the Department has been proactive in formalizing strategic and operational plans that are tied to government objectives and priorities. Management contracts have also emerged, which are meant to further strengthen managers' accountability. We have significant concerns about the reliability of information meant for monitoring and analyzing program statistics. As the Department accelerates its shift to an information-based organization, it needs to check its data to ensure that they are in an appropriate form for analysis and are accurate.

31.128 We observed that the Department's systems are not efficiently supporting the financial reporting requirements of the federal government and that practices in this area require more rigour. One particular concern is that Revenue Canada does not perform all of the reconciliations that we believe are needed for good financial management. Aside from revenue reporting, we found that stakeholder needs are largely met.

31.129 Overall, in our opinion, Revenue Canada is now at a stage of maturity where it needs to devote much more attention and assign a higher priority to ensuring effective and efficient financial management throughout the organization. We acknowledge that a number of departmental initiatives are either planned or under way that are poised to strengthen several aspects of the Department's financial management regime.

About the Audit

Objective

Overall, our objectives were to determine whether:

- Revenue Canada's financial management function provides adequate safeguards to minimize financial risks and protect financial assets;
- the Department's financial management regime adequately supports management in achieving program objectives in an efficient and cost-effective manner:
 - the Department's strategic and operational plans reflect government priorities and legislated requirements;
 - adequate systems and practices are used by management to determine the resources required to meet commitments and to account for their use;
 - systems effectively provide necessary information to support accountability reporting, performance monitoring and financial risk management;
- there are adequate controls over the accuracy of revenue reports in *The Fiscal Monitor* and in the Public Accounts; and
- financial and departmental performance information provided to key stakeholders is sufficient, timely, relevant and reliable.

Scope

We examined financial management and control from three broad perspectives. Specifically, we looked at:

- the Department's handling of two of its key fiduciary responsibilities — revenue reporting and cash management;
- the key administrative functions that underpin an effective financial management control regime — namely, planning, budgeting, funding, performance monitoring and reporting; and
- the organization and priorities of Revenue Canada and how these affect its financial management control systems.

We limited our work to those systems and practices that support revenue-related operations. Our audit did not cover:

- the management and accuracy of the more than 22 million taxpayers' records that Revenue Canada maintains;

- the Department's operating expenditures;
- Revenue Canada's policies and practices for controlling fraud;
- the management of the Department's investment in facilities and other capital assets.

Approach

In carrying out our audit, we drew on knowledge gained from previous revenue-related audits that our Office has carried out over the past four years, updated to reflect the results of our follow-up work. All of those audits considered some aspects of financial management and control.

We conducted our audit work at Revenue Canada's headquarters and in all regional offices, and in several tax centres and tax services offices across Canada. We also interviewed officials at Statistics Canada, the Receiver General of Canada and the Department of Finance to learn about their respective roles in relation to financial reporting, including cash management, and in relation to the sufficiency, quality and reliability of financial and operational information in general supplied by Revenue Canada for input into tax policy, fiscal policy or economic and demographic forecasting.

We also visited officials of the Internal Revenue Service and the General Accounting Office in the U.S., and Inland Revenue and the National Accounting Office in the United Kingdom to obtain a perspective on overall trends in financial management and control and on initiatives to establish formal accountability structures for financial management and control in their respective jurisdictions. We also visited a major Canadian financial institution to obtain a private sector perspective on financial management and control practices in the banking industry for the areas covered in our audit. We also obtained their views on present banking arrangements for processing taxpayer remittances and other tax transactions.

Audit Criteria

We expected that:

- Responsibility for financial management and control would be clearly defined, and related accountability would be clearly established and monitored.
- Before it makes decisions, the Department would understand their financial implications backed by relevant, accurate, timely information and analysis and objective rigorous challenge as appropriate.
- The Department would have adequate systems and practices to identify and control financial risks.
- The Department's management information systems would produce the type of reliable information that it needs to properly plan, control and accurately account for funded resources to deliver on commitments.
- The Department would have clear, measurable performance expectations for its programs and operations and monitor the extent to which its results reflect its expectations. Managers would be held to account for results achieved.

- The Department would have systems for meeting legal reporting requirements and for providing any program, financial and performance information that Parliament, the central agencies and others might reasonably expect. This information would be complete, accurate, timely and relevant to their needs.
- The Department would comply with financial executive authority and central agency requirements in matters connected to keeping within established spending limits , ensuring that spending is as authorized, collecting revenues only as authorized, and recording and reporting revenues and expenditures as required.
- The Department would have appropriate and effective systems and procedures for cash management. Essential records would be maintained and procedures applied would be sufficient to secure an effective check on the assessment, collection and proper allocation of revenues.

Audit Team

Richard Quesnel
Abid Raza
Tony Brigandi
Jean-Luc Tétreault
Shahid Maqsood
Nicole Petrin-Bertrand
Arun Thangaraj
Sophie Chen
Olivia Zhu

For information, please contact Basia Ruta, the responsible auditor.

Chapter 32

Revenue Canada and Department of Finance

Understanding Changes in Tax Revenues: GST

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Revenue Canada and Department of Finance

Understanding Changes in Tax Revenues: GST

Assistant Auditor General: Shahid Minto
Responsible Auditors: Scott Milne and Jim Ralston

Main Points

32.1 Chapter 31 of this Report highlights the importance of appropriate, sufficient and timely analyses to understand fluctuations in various revenue streams. Good analyses can improve the government's ability to identify errors, increase the government's awareness of new economic trends, enhance the credibility of the financial information reported to Parliament, and improve the accuracy of the government's forecasts of tax revenues, deficits and net borrowing needs. Good analysis of revenue movements also supports Revenue Canada's programs and initiatives to identify tax avoidance techniques being used by registrants or to note changes in registrant compliance.

32.2 In this chapter, we consider what would constitute an appropriate process for analyzing movements in revenue streams, the minimum extent to which the process should be followed, and the factors that hamper the attempts of Revenue Canada and the Department of Finance to understand changes in tax revenues. To do so we selected, as an example, the \$400 million decrease in net Goods and Services Tax (GST) that occurred from 1994-95 to 1995-96 (from \$16.8 billion to \$16.4 billion), and reviewed the departments' attempts to analyze it.

32.3 Both Revenue Canada and Finance are satisfied that the amount of effort they devoted to finding an explanation for the decrease in net GST was appropriate given the size of the decrease and the nature of the available information. However, no conclusive explanation for the decrease has been found.

32.4 We believe that Revenue Canada and Finance followed an appropriate analytical process to a certain extent. We believe, however, that the process needs to be followed more fully. As a minimum, the departments need to adjust for bookkeeping errors and distortions caused by the cash basis of accounting before assessing the extent to which further analyses are required. If the need for further analysis is revealed, the departments could consider additional factors related to changes in the economy and in registrant behaviour to obtain a more robust explanation of changes in GST revenue.

32.5 Although the departments made attempts at analyzing the decrease in GST revenue, problems with the reliability and timely accessibility of some of the data, as well as the lack of other data, inhibited their efforts. Ensuring the reliability and timeliness of the data, and making more use of available and reliable data, would improve the departments' ability to conduct timely analyses. Collecting additional information from some or all registrants could improve the departments' analytical capabilities. The government will need to maintain a balance between its need for more information for analysis and compliance purposes and the increased burden it places on registrants to provide the information and on Revenue Canada to capture and store it.

32.6 Revenue Canada could improve its analytical capability by ensuring that a sufficient, proactive, timely and co-ordinated effort is mounted by the various units within the Department to analyze GST revenue.

Introduction

Focus of the audit

32.7 Many of our previous audits and Chapter 31 of this Report highlight the importance of appropriate, sufficient and timely financial analyses to understand fluctuations in various revenue streams. This chapter explores whether opportunities exist to improve the analyses of revenue movements performed by Revenue Canada and the Department of Finance. In our audit, we selected, as an example, the analyses carried out by the departments to understand the \$400 million decrease in net GST revenue from 1994-95 to 1995-96.

32.8 We selected the analyses of the \$400 million decrease for several reasons. First, the decrease had not been expected. In its 6 March 1996 Budget, the government forecast that net GST revenue for 1995-96 would be \$17.2 billion — a \$400 million increase over 1994-95 as opposed to a \$400 million decrease. Second, net GST had increased from 1992-93 to 1993-94 and from 1993-94 to 1994-95 (see Exhibit 32.1). Third, we were aware that the government had considered the decrease to be significant.

Exhibit 32.1

(This exhibit is not available, see the Report)

32.9 Further details on the audit objective, scope and criteria are presented at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Why It Is Important to Understand Changes in Tax Revenues

32.10 It is important for Revenue Canada and the Department of Finance to analyze and explain fluctuations in all tax revenues, including GST. The better the analysis, the better the government's ability to identify errors, if any, in the amounts reported monthly in *The Fiscal Monitor* or annually in the Public Accounts of Canada. Good analysis can also increase the government's awareness of new economic trends, enhance the credibility of the financial information reported to Parliament, and improve the accuracy of the government's forecasts of tax revenues, deficits and net borrowing needs.

32.11 Good analysis of revenue movements supports Revenue Canada's programs and initiatives to identify tax avoidance techniques being used by registrants or to note changes in registrant compliance. Revenue Canada needs to identify developments such as these in order to amend its compliance strategies accordingly.

32.12 The impacts of errors, distortions, economic trends, tax avoidance techniques and changes in registrant compliance may offset each other. Therefore, even in the absence of large fluctuations, there need to be sufficient ongoing analyses to ensure that all items requiring action are identified. Such analyses would include the day-to-day work being performed by the various units within Revenue Canada and Finance to monitor, among other things, changes in the economy and in registrant behaviour.

The analysis of the \$400 million decrease in net GST revenue was inconclusive

32.13 When analyzing the \$400 million decrease in net GST, Revenue Canada and Finance identified a number of factors that could have contributed to the decrease. These factors were documented in various internal

documents, including several drafts of an internal “Analytical Note” that Finance prepared and discussed with Revenue Canada. However, the Analytical Note and the other internal documents came to no conclusion on which of the possible explanations were favoured, and the potential impact of some of the factors on net GST had not been determined. The impact of these unquantified factors could have been significant.

32.14 One of the possible explanations identified was “lags in processing of refunds and rebates pertaining to 1994-95.” This was the explanation used in the *Annual Financial Report of the Government of Canada: Fiscal year 1995-96*, issued in October 1996. However, the Analytical Note and other documents provided to us did not contain sufficient support for the explanation.

32.15 In our opinion, given the limited extent to which the process was followed (see paragraphs 32.20 to 32.24) and the limitations of the data (see paragraphs 32.25 to 32.30), the analysis of the \$400 million decrease in net GST was inconclusive. To better understand this, we considered what would constitute an appropriate process for analyzing movements in GST and in other revenue streams, the minimum extent to which the process should be followed, and the factors that hampered the departments’ attempts to understand changes in GST revenue. Our findings may point to ways in which the analytical capabilities of both departments can be strengthened so that future fluctuations in GST revenue can be better understood.

How the GST works

32.16 To better understand the task faced by Revenue Canada and Finance in analyzing GST revenue, it is important to understand how the GST operates and the magnitude of the amounts involved. Exhibit 32.2 presents a simple example of how the GST operates, and notes two implications for the analysis of GST revenue. Exhibit 32.3 contains a “standard” GST return.

Exhibit 32.2

(This exhibit is not available, see the Report)

Exhibit 32.3

(This exhibit is not available, see the Report)

32.17 As illustrated in Exhibits 32.2 and 32.4, the gross GST collected and collectable (referred to as “GST declared” in this chapter) and the input tax credits (ITCs) claimed by registrants are much greater than Revenue Canada’s cash receipts and refunds.

Exhibit 32.4

Comparison of GST Declared and Input Tax Credits (ITCs) Claimed with Cash Receipts and Refunds — 1995-96 (in \$millions)

	Illustrative Breakdown of GST Received per Public Accounts	Illustrative Breakdown of GST Refunds per Public Accounts	Reconciliation of GST Declared and ITCs Claimed to Net GST per Public Accounts
GST Declared	A \$60,000	B \$33,500	C \$93,500
ITCs Claimed	D (21,900)	E (50,000)	F (71,900) ¹
GST per Public Accounts before Items Listed below	G \$38,100	H \$(16,500)	I 21,600
Rebates, Paid by Government Ministries to Registrants and Quarterly Tax Credits²			J 5,200
Net GST			K \$16,400

The amounts in boxes C and F can be extracted from Revenue Canada's accounting systems. Box C is composed of, among other things, amounts reported by registrants on their GST returns and GST collected at the border by Customs. Box F is composed of, among other things, amounts claimed by registrants on their GST returns. Except for the portion of the box C amount collected at the border by Customs, these amounts are unaudited.

The amounts in boxes G, H, I, J and K are available from Revenue Canada's accounting systems, and have been audited as part of our audit of the Public Accounts of Canada.

The amounts in boxes A, B, D and E are not available. While the data required to produce these amounts are captured by Revenue Canada's accounting systems, these systems were not designed to track GST declared and ITCs claimed separately for GST returns with receipts and GST returns with refunds. We have entered fictitious amounts in these boxes for illustrative purposes only.

The purpose of this illustration is to show that the cash receipt and refund amounts (boxes G and H) reported by the government do not contain important information that is needed for an analysis of GST revenue movements. They also do not show the extent of the turnover of transactions associated with a multi-stage sales tax like the GST: for every dollar of net GST revenue retained by the government, about \$4.30 (\$93,500 million divided by \$21,600 million) is collected from purchasers of goods and services.

¹ For 1995-96, the net GST position, using GST declared (box C) and ITCs claimed (box F), was approximately \$500 million less than the \$21,600 million in the Public Accounts of Canada. The difference could have been caused by numerous factors, such as a registrant submitting a GST return in 1995-96 but Revenue Canada not issuing the refund cheque until 1996-97. While the difference would most likely relate to both boxes C and F, for simplicity we have reflected all of it in box F.

² The quarterly tax credits represent \$2,800 million of the \$5,200 million in box J. These credits are paid to families and individuals with low or modest incomes to help them offset all or part of the GST that they pay. As such, they represent a social transfer program, and are not part of the GST system itself. They are included in this exhibit as this is how the government reports them in the Public Accounts of Canada.

Source: Revenue Canada and/or the Public Accounts of Canada - amounts in boxes C, F, G, H, I, J and K.

32.18 The gross amounts are also much greater than the net GST the government retains. Exhibit 32.4 shows that in 1995-96, for every dollar of net GST revenue kept by the government, registrants collected about \$4.30 of gross GST revenue from purchasers of goods and services. The difference of \$3.30 does not represent “leakage” in the system, or administrative costs of collecting the GST. Rather, it is a by-product of the mechanism used to ensure that only the value-added portion of transactions is taxed.

What Is Needed to Understand Changes in GST Revenue

32.19 This section discusses four requirements to understand changes in GST revenue — following an appropriate process, having and making use of reliable and timely data, co-ordinating the analyses among the decentralized units within Revenue Canada, and obtaining enough information from registrants.

Following an appropriate analytical process

32.20 Exhibit 32.5 outlines a process for analyzing GST revenue movements. We believe that the process is appropriate for analyzing movements in all revenue streams and for analyzing both variances from budgeted amounts and changes from previous years’ actual amounts. Revenue Canada and Finance officials have informed us that this is the process that they generally follow. The process reflects the cash basis of accounting being used by the government for recording tax revenues. However, this basis of accounting could distort the reported GST amounts. For example, slower processing of GST refunds by Revenue Canada at the end of 1994-95 would mean that refunds normally issued in 1994-95 would be issued in 1995-96. As a result, GST revenue would be higher in 1994-95 and lower in 1995-96.

Exhibit 32.5

An Appropriate Process for Analyzing GST Revenue Movements

1. Start with amounts for both years using the government’s cash basis of accounting.
2. Adjust these amounts for known bookkeeping errors in each year.
3. Adjust these amounts further to eliminate distortions caused by the cash basis of accounting.
4. Consider the impact of changes in the economy on the adjusted amounts.
5. Consider the impact of changes in registrant behaviour on the adjusted amounts.

While this chapter only deals with the analysis of a change in GST revenue from the previous year’s actual, we believe that the process would also be appropriate for other revenue streams and for analyzing variances from budgeted amounts.

The process reflects the cash basis of accounting currently being used by the government for recording tax revenues. However, the government has announced its intention to implement accrual accounting for tax revenues. When accrual accounting has been implemented, steps 1 and 3 of the process will require amendment.

32.21 We believe that, even in the absence of large fluctuations, as a minimum the first three steps of the process outlined in Exhibit 32.5 need to be performed. This is to ensure that bookkeeping errors or distortions caused by the cash basis of accounting are not concealing large variations caused by changes in the economy or changes in registrant behaviour.

32.22 Revenue Canada and Finance did not complete steps 2 and 3 of the process. As part of step 2, they identified \$245 million in bookkeeping errors, but did not fully perform certain reconciliations and other procedures

required to detect misclassifications between GST and other revenue streams, such as customs import duties or corporate income tax. Eliminating the identified bookkeeping errors leaves an apparent unexplained residual of \$155 million. However, because the departments did not complete step 2 and because, for step 3, they did not fully investigate a number of potential distortions caused by the cash basis of accounting, it is not safe to conclude that \$155 million is the amount of the residual to be explained. Some of the potential distortions were significantly large to pose a risk that the residual could have been much greater than \$155 million. If this were so, it would have affected the departments' need to perform steps 4 and 5 of the process.

32.23 For steps 4 and 5 of the process, the departments could have considered additional circumstances affecting GST revenue. For example, for step 4 they could have more fully considered changes in economic factors. For step 5, they could have more fully considered the potential impacts of registrants' increased knowledge of the GST legislation.

32.24 When analyzing GST revenue movements, Revenue Canada and the Department of Finance should, as a minimum, adjust for bookkeeping errors and distortions caused by the cash basis of accounting, and then assess the extent to which further analyses are required. The required analyses should then be performed.

Departments' joint response: As noted in the Main Points, Revenue Canada and the Department of Finance followed the appropriate analytical process for the analysis of the \$400 million decline in GST revenues. While it is important to understand changes in collections from year to year, it is also important to compare the outcome to the budget forecast based on underlying economic developments affecting the tax base. The focus of Finance's work was explaining the forecast variance, as well as the year-to-year change.

The Analytical Note put forward a number of possible factors that could have contributed to the forecast variance. The potential contributions of these factors were evaluated by looking at all available relevant data and information. In some instances, certain pieces of information were viewed as unreliable for making precise quantitative estimates of the impact of some factors. In some other instances, the data were not available on a timely basis to contribute to the analysis. For example, the historical revisions to Statistics Canada data, which we will use to refine our estimate of the underlying GST base, have not yet been released.

In addition to analysis conducted specifically to answer questions related to issues raised in the Analytical Note, Revenue Canada and Finance drew upon their ongoing day-to-day monitoring and analysis of GST revenues to guide them as to the potential importance of certain factors. At the aggregate level, the departments track trends in revenue performance for all revenue sources. Additional analysis of the various revenue components is undertaken to examine compliance patterns and identify potential problems. For the GST, analysis is undertaken at the individual registrant level to assess all GST returns, including ITCs claimed, credit returns and rebates, for risk of non-compliance.

In our view, revisions to the economic data, together with the identified bookkeeping adjustments, account for the variance in the revenue forecast. Accordingly, Revenue Canada and Finance are satisfied that they have adequately explained why GST revenues came in below forecast. That said, we will continue to revisit this issue as new and revised economic data for this period become available.

We would also note that after taking into account the \$245 million in adjustments referred to in paragraph 32.22, the decline in GST would have been about \$150 million or half of one per cent of gross GST revenues. This is well within the range of normal month-to-month fluctuations in GST revenues and the materiality threshold for analysis purposes.

Having and making appropriate use of reliable and timely data

32.25 To adequately follow an analytical process, Revenue Canada and the Department of Finance need to have, and to make appropriate use of, reliable and timely data. In our previous audits, we have expressed concerns about the reliability of the data emanating from Revenue Canada's systems. Moreover, Chapter 31 of this Report notes significant ongoing concerns about the reliability of information meant for use in monitoring and analyzing program statistics, trends and performance.

32.26 Exhibit 32.6 lists some of the data that the departments had available to explain the \$400 million decrease in net GST. Some of the data were not used; other data were not used to the extent required to explain the decrease. Finance officials have informed us that they have concerns about the reliability and the timeliness of some of the data that they did not use.

Exhibit 32.6

Available Data

Data that Revenue Canada and the Department of Finance had available to explain the \$400 million decrease in net GST include:

- information such as GST receivables, refunds payable and GST offsets (applying what would otherwise have been a GST refund to amounts owing for other revenue streams) that could be used to identify distortions caused by the cash basis of accounting;
- industry sector data that could be used to determine the sectors in which the fluctuations have occurred, and the composition of registrants within those sectors;
- information on GST returns submitted by registrants, including the amounts for sales, GST declared and input tax credits claimed;
- additional GST information pertaining to individual registrants, such as the results of reviews of GST returns prior to issuing refund cheques;
- aggregate and individual registrant data from other revenue streams, such as customs import duties and excise taxes and duties;
- monthly GST data that can be used to indicate the months in which unexplained differences had occurred; and
- economic data from the System of National Accounts provided by Statistics Canada.

32.27 The analyses performed by Revenue Canada and Finance were based primarily on receipts and refunds. The data listed in Exhibit 32.6 include GST declared and input tax credits (ITCs) claimed. We believe these would be better bases to use for analysis purposes. There are concerns, though, about the reliability of the recorded amounts for GST declared and ITCs claimed because they are not reconciled to the cash receipts and refunds. Revenue Canada regards the performance of this reconciliation to be a formidable task.

32.28 As noted in Chapter 31, Revenue Canada has recognized that some inefficiencies exist in current systems and these are being addressed as part of a major re-engineering initiative currently under way in the Department.

32.29 **Revenue Canada and the Department of Finance should continue to work toward improving the reliability and the timeliness of the GST data, and should make more use of available and reliable data to the extent called for during each step of the analytical process.**

Departments' joint response: Revenue Canada, in consultation with the Department of Finance, is continuing its efforts to improve the quality and timeliness of information used for revenue analysis and other purposes. The re-engineering process that is currently under way, which includes the standardization of accounting systems, should

be particularly helpful in this regard. Finance will continue to monitor and analyze economic developments with regard to their impact on revenue flows.

32.30 Revenue Canada should find ways to reconcile the net of the GST declared and input tax credits claimed to the net of the cash receipts and refunds.

Departments' joint response: The suggested reconciliation is not feasible in the context of the current accounting structure of the GST mainframe system, which was built on the concept of reporting in the Public Accounts on a modified cash basis. It will be considered as part of the move to standardize accounting systems and the government's intention to move to full accrual accounting.

Co-ordinating analyses among decentralized units

32.31 Some GST analyses, such as a detailed consideration of economic factors, would best be performed by the Department of Finance. Other GST analyses would best be performed by Revenue Canada. These include, for example, a comparison of GST data with data from other revenue streams, and analyses at the individual registrant level.

32.32 Revenue Canada has a shared and decentralized financial management framework. Responsibility for the performance of analyses for GST and other revenue streams is shared among, for example, Revenue Canada's Finance and Administration at headquarters and the various program branches and directorates, such as Compliance Research. An interdepartmental Fiscal Monitor Committee, with representatives from both Revenue Canada and the Department of Finance, deals with reporting issues. It is largely in this forum that questions on revenue fluctuations are raised by Finance for follow-up or analysis by Revenue Canada. While Revenue Canada and Finance officials believe that the Fiscal Monitor Committee is providing a good forum for dealing with issues and for understanding respective needs and constraints, Finance would like Revenue Canada to do more independent analysis and, in response to queries raised, more timely analyses.

32.33 As noted in Chapter 31, it was not evident that there was any guidance provided by Revenue Canada headquarters to the program branches and directorates on the nature and frequency of routine analyses to be performed, or on the sources of information to be used. We also found that program branches are not provided with any parameters on what constitutes significant fluctuations requiring investigation. For the most part, analyses are performed only on a reactive basis (not a proactive basis). As a result, they may be done too late, or may not be done at all. Revenue Canada officials have informed us that, in concert with Finance, they will continue to develop specific performance measures that prompt investigative action and will report on them regularly.

32.34 Revenue Canada should ensure that a sufficient, proactive, timely and co-ordinated effort is mounted by the various units within the Department to analyze GST revenue.

Departments' joint response: In addition to the response to recommendation 32.24, the Fiscal Monitor Committee, which is co-chaired by the Director General, Financial Administration at Revenue Canada and the Director, Fiscal Policy, Department of Finance, co-ordinates revenue analysis activities. The committee has representatives from all program revenue branches. The Revenue Accounting and Reporting Division within the Financial Administration Directorate supports its activities. A year ago, terms of reference were established for the Fiscal Monitor Committee to ensure a common understanding of the expectations and respective roles in revenue analysis and to support the monthly revenue analysis cycle, which had been followed in an informal manner for some years.

Obtaining enough information from GST registrants

32.35 Although improving the reliability and the timeliness of the data, and making better use of them, would improve the ability of Revenue Canada and Finance to analyze GST revenue movements, it may not be enough. Additional registrant data may be required.

32.36 The GST return (Exhibit 32.3) asks for very little information. For example, it does not require the registrant to provide any breakdown of the sales amount into its taxable and non-taxable components. In addition, when the Harmonized Sales Tax (HST) was introduced, the GST return was not amended to require registrants to provide a breakdown of the sales amount to distinguish sales made in the three Atlantic provinces subject to the HST (taxed at 15 percent) and sales made in the rest of Canada (taxed at 7 percent). Changes in the ratio of taxable sales to total sales, or in the ratio of sales taxed at 15 percent to sales taxed at 7 percent, would distort the relationship between total sales and GST declared. In addition, the portion of the GST return submitted to Revenue Canada does not include the “adjustments” amount reported in line 104 on the top part of the return (the working copy). Large adjustments could also distort the relationship between sales and GST declared.

32.37 One way for Revenue Canada and Finance to obtain more information on sales and GST declared would be to amend the portion of the GST return submitted to Revenue Canada by some or all registrants to include adjustments and additional information on the sales amount.

32.38 An alternative, which could provide even more information on sales but at greater cost to the affected registrants, would be to require some or all registrants to provide an annual reconciliation of sales reported on their financial statements to the sales reported on their GST returns for the year. This reconciliation could be included as part of the registrant’s corporate income tax return (incorporated registrants) or personal income tax return (unincorporated registrants). It could include information on sales of capital assets and the main categories of non-taxable sales.

32.39 Similar arguments can be made regarding the need to clarify what is included in the purchases and related input tax credits being claimed by registrants. Currently, there is no requirement for registrants to provide an amount for purchases on their GST returns.

32.40 Trade-offs. Obtaining more information from registrants would give Revenue Canada and Finance more confidence in the reliability of the amounts being reported, and more information for analysis and enforcement purposes. However, it would increase the registrants’ administrative burden. While some registrants may have this information readily available, others may not. The government will need to maintain a balance between its need for more information for analysis and enforcement purposes and the increased burden it places on registrants to provide the information and on Revenue Canada to capture and store it.

32.41 If Revenue Canada and the Department of Finance are unable to adequately explain fluctuations in GST, even after improving the reliability and timeliness of the available information and making better use of it, they should consider requesting additional information from some or all registrants.

Departments’ joint response: As the Auditor General indicates, there is a need to balance the desirability of additional information for analytical purposes with the additional burden that requiring reporting of this information imposes on taxpayers. The Department of Finance and Revenue Canada will continue to monitor the level of information required from registrants to ensure that this is appropriate in light of these considerations.

Conclusion

32.42 In this chapter, we considered what would constitute an appropriate process for analyzing movements in revenue streams, the minimum extent to which the process should be followed, and the factors that hampered the attempts of Revenue Canada and the Department of Finance to understand changes in tax revenues. To do this, we selected, as an example, the \$400 million decrease in net GST that occurred from 1994-95 to 1995-96 and reviewed the departments' attempts to analyze it. We found that while the process was followed to some extent, the departments had not completed what we consider to be the minimum procedures required.

32.43 To the extent that analyses of GST revenue are hampered by unreliable, untimely and unavailable data, it is important that Revenue Canada and Finance work toward improving the quality and timeliness of the data, and consider requesting more information from registrants. Co-ordinating analyses of GST within Revenue Canada could improve the Department's analytical capability.

About the Audit

Objective

The objective of this audit was to determine whether opportunities exist to improve the analyses of GST revenue movements.

Scope

We assessed the nature and extent of the analyses carried out by Revenue Canada and the Department of Finance to explain the \$400 million decrease in net GST revenue from 1994-95 to 1995-96.

We did not review the forecasting methodology used by the Department of Finance. Nor did we attempt to assess the nature and extent of the analyses performed to explain the \$800 million difference between the 6 March 1996 Budget forecast and actual GST revenue.

Our examination was conducted in the headquarters of Revenue Canada and of the Department of Finance. It consisted of interviews and a review of the analyses performed by the departments and of other relevant documents.

The scope of the audit was co-ordinated with that of Chapter 31, Revenue Canada — The Financial Management Regime.

Criteria

We expected that Revenue Canada and the Department of Finance would be able to identify and adequately explain significant variances in GST revenue. More specifically, we expected that the departments would:

- follow an appropriate analytical process;
- ensure that the data required to perform the analyses were reliable and available on a timely basis;
- perform rigorous analyses, making appropriate use of the data;
- co-ordinate the analyses among the various units within the departments; and
- explain the variance clearly and accurately in both internal and external reports.

Audit Team

Mimi Hong
Patricia Smith

For information, please contact Scott Milne or Jim Ralston, the responsible auditors.

Chapter 33

The Correctional Investigator Canada

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The Correctional Investigator Canada

Assistant Auditor General: Maria Barrados

Responsible Auditor: Robert W. Chen

Main Points

33.1 The Office of the Correctional Investigator was first established in 1973 under the *Inquiry Act*, and formalized in 1992 under the *Corrections and Conditional Released Act* “to conduct investigations into the problems of offenders”. Although it is a small agency, the Office plays a very important role in ensuring fairness for those inmates serving sentences in Canada’s federal prisons. Its findings and recommendations can also help to improve systems and practices in Correctional Service Canada.

33.2 Over the years, the Office has accumulated a set of management practices. We found that while these practices are often helpful in resolving individual complaints, they are not conducive to efficient and consistent handling of cases and have contributed to the Office’s adversarial relationship with Correctional Service.

33.3 The Office needs to improve its operational strategies and management practices to reflect changes that have occurred in the correctional environment and in legislation since 1973. The Office needs to prioritize its activities on an informed basis in order to effectively manage its workload. It needs to establish policies and procedures to help its staff in investigating individual complaints. It also needs to improve the quality of its management information systems and provide better performance information in its annual reports.

33.4 Given the important role of the Office, improvements in its management are needed so it can better fulfil its mandate within the Canadian criminal justice system.

Introduction

The role of the Correctional Investigator

33.5 The Office of the Correctional Investigator (the Office) is a federal entity that deals with the complaints of inmates who are serving sentences of longer than two years in federal corrections facilities. The Office has 16 full-time-equivalent staff, all located in Ottawa. It is headed by the Correctional Investigator, who is supported by an executive director, a legal advisor, two directors of investigations, eight investigators and a small group of administrative support staff.

33.6 The Office's total annual budget is \$1.3 million, of which approximately \$1 million is for salaries and related personnel costs. The balance is used for operating expenses such as transportation, communications, utilities and supplies. Its work entails regular visits to more than 40 federal correctional facilities.

33.7 The Correctional Investigator's role is to receive, investigate and report on complaints by individual inmates and on system-wide issues that give rise to these complaints. He may also investigate problems on his own initiative, and any problems brought to his attention by the Solicitor General. He also has authority to recommend changes to the applicable law, practices or policies, where appropriate. The Correctional Investigator has wide discretion to decide whether an investigation should be undertaken; however, the Act sets out how it should be brought to conclusion.

The importance of having a corrections ombudsman in Canada

33.8 Even though he heads a small agency with a small budget, the Correctional Investigator plays a very important role as ombudsman for the approximately 15,000 inmates of Canada's federal prisons. In 1971, following a riot at Kingston Penitentiary, a Commission of Inquiry concluded that an external grievance body was needed to independently review inmate complaints and thereby reduce the potential for future occurrence of similar disturbances. In 1973, pursuant to Part II of the *Inquiries Act*, the government appointed a commissioner to be known as the Correctional Investigator.

33.9 In 1992 the position of Correctional Investigator was established formally in Part III of the *Corrections and Conditional Release Act (CCRA)*. The mandate of the agency is to "conduct investigations into the problems of offenders".

The general role of an ombudsman

33.10 The notion of righting a wrong is central to the ombudsman role. An ombudsman exists to provide an independent, objective opinion on the fairness of government services — to counterbalance the relative strength of public institutions against the individual. A successful ombudsman is one who increases the public's confidence in public administration.

33.11 Some of the more common features of ombudsman offices, including the Correctional Investigator's, are the following:

- They emphasize easy access for all individuals requiring the service.
- They have powers of investigation.

- They make non-binding recommendations.

This last feature — the non-binding nature of the recommendations — is considered critical because it ensures that the ombudsman will not become just another component of management. If the ombudsman is to remain effective, he or she must be perceived by both the public and the bureaucracy as completely independent and impartial.

33.12 An ombudsman’s strength lies in the ability to persuade others of the value of any recommendation or opinion flowing from an investigation. Consequently, the working relationship between the ombudsman and the institutions within the scope of his or her mandate must be carefully balanced. The nature of the work implies that this relationship can be neither too cordial nor too adversarial. This balance of creative tension is not easy to achieve, but it is very important.

Providing the service

33.13 The process the Office administers is complaint-driven. Complaints may be made in writing or orally — in the latter case, to investigative staff either during an institutional visit or by telephone (inmates may place a collect call to the Office). An inmate may raise his complaint with the Correctional Investigator, or friends and family members may do so on his behalf. After the Office receives a complaint by mail or by telephone, an interview may be scheduled for the next institutional visit by Correctional Investigator staff. In 1996-97, they conducted more than 2,000 interviews.

33.14 Typically, problems raised by inmates relate either to conditions in the institutions, such as pay and health care, or to decisions of Correctional Service Canada staff, such as those related to transfers, temporary absences and visits. What the Office of the Correctional Investigator does, broadly speaking, is to intervene formally or informally on behalf of an inmate when it receives a complaint. This usually involves trying to resolve the complaint with Correctional Service officials.

33.15 The Office is also involved in providing information and advice to inmates. Sometimes the inmate is advised to first exhaust Correctional Service’s internal complaint process, which consists of four levels, two of which are specific to the institution where the inmate resides. The remaining two levels are administered at regional headquarters and national headquarters respectively (see Exhibit 33.1).

Exhibit 33.1

Volume of Complaints and Grievances (1996-97) in Correctional Service’s Four-Level Grievance System

Level	Responsible Correctional Service Officer	Volume
Complaint	Section Head in Institution	16,600
First Level Grievance	Warden or District Director	2,953
Second Level Grievance	Deputy Commissioner in Region	1,889
Third Level Grievance	Commissioner’s Representative at Headquarters	822

33.16 In other cases, the Correctional Investigator’s staff will intervene by pursuing the matter with Correctional Service staff. This kind of assistance often leads to a speedy resolution of the problem, if the two sides of an issue can be reconciled without formalities. In cases where there is an oversight, Correctional Service will take remedial action.

33.17 By providing an external review, the Correctional Investigator is in a good position to redress individual injustices and to address the defects in the system (“systemic issues”) that are causing inmates to complain. As is true for other corrections ombudsman, the Office can also fulfil the function of “safety valve”.

Focus of the audit

33.18 The aim of our audit was to determine the extent to which the policies and procedures of the Office of the Correctional Investigator have enabled it to carry out its mandate effectively. We focussed our examination on how well the Office has managed its operations, measured its performance and reported on the results of its work. Details on our audit scope and criteria can be found at the end of the chapter, in **About the Audit**. Our audit did not include a review of Correctional Service Canada, other than its dealings with the Correctional Investigator relating to inmate complaints.

33.19 In addition to interviewing Correctional Investigator staff, examining the Office’s documents and reviewing sample case files, our audit work involved interviews with inmates, Correctional Service Canada personnel and other stakeholders, as well as other ombudsmen, both past and present.

33.20 We reviewed the annual reports of a number of other ombudsmen, both general ombudsman and corrections ombudsman; some of their policy and procedures manuals; as well as reports and proceedings of parliamentary committees. We also conducted an extensive literature review.

33.21 Although the Office’s clients include both inmates and offenders under community supervision, the bulk of its work is with inmates. For simplification, we use the term “inmates” throughout the chapter and in the male gender, although there are also female inmates.

Observations and Recommendations

Mandate and Strategy

Plans lack action steps to deal with recognized problems

33.22 Imprisonment is a condition that, by nature, creates tension and dissatisfaction and leads to many complaints. The demand for the Office’s services is incessant. As it has reported, both the demand for its services and the complexity of the issues involved have increased in recent years. Yet the Correctional Investigator is still expected to meet mandated responsibilities such as informing inmates of its existence and function, investigating their problems, making recommendations to solve the problems, and reviewing all investigations by Correctional Service into incidents of death or serious bodily injury.

33.23 Under these conditions, it is important that the Office set priorities among its activities and develop a plan for carrying them out. Such a plan of action would focus the Correctional Investigator’s efforts on the most important of its mandated responsibilities, and enable the organization to make the best use of its resources. The Correctional Investigator prepares an expenditure plan for the Estimates and a business plan. However, while the Office identifies a number of initiatives, it does not clearly set out action steps, their relative priorities, and how they are going to be resourced. For example, our audit found that although the Office of the Correctional Investigator has identified coping with the volume of workload and maintaining a thorough and responsive investigative process as the most critical issues, it does not have an action plan that can address these issues effectively in relation to its other ongoing activities.

Managing the workload

33.24 The Office of the Correctional Investigator operates with a small staff. The staff have indicated that they feel overwhelmed by demand and volume. Our audit also found that the Office had problems with managing the work processes, providing timely responses to complaints and maintaining the number of visits to the institutions.

33.25 Last year the Office received approximately 7,000 contacts from inmates and their families. Each contact requires time and attention to determine how it should be dealt with. Some involve little work, while others can result in significant investigative effort. The Correctional Investigator estimates that, on average, the caseload is approximately 850 contacts per investigator. This is in addition to other responsibilities arising from the new legislation and other initiatives.

33.26 The Office does not differentiate among contacts according to the extent of the work required. According to statistics it has reported, contacts by inmates that were dealt with by giving information or advice, or concluded to be “premature”, have grown in proportion from 43 percent in 1992-93 to 56 percent in 1995-96 (see Exhibit 33.2). Providing information and advice can be beneficial to inmates, especially because they do not always have easy access to other sources. However, there is no guidance provided to investigators that sets out a more streamlined process for the contacts requiring least attention. Better management of requests for information and advice can free up some of the Office’s limited resources for activities such as investigating inmates’ complaints to the extent defined in the legislation and conducting systemic reviews that deal with the root causes of the complaints.

Exhibit 33.2

(This exhibit is not available, see the Report)

33.27 An inmate is not required to exhaust all of Correctional Service Canada’s internal avenues of redress before seeking the Correctional Investigator’s involvement. Consequently, when a complaint is received by the Office, the investigative staff often suggest to the inmate that he first discuss it with institutional staff or pursue the internal grievance process. Our data analysis revealed that cases like this represent approximately 50 percent of all cases received by the Correctional Investigator. These could include some of the contacts concluded by giving information or advice or closed as premature.

33.28 We estimated that in 15 to 38 percent of the cases, the inmate had contacted both the Office and Correctional Service with the same complaint. We were unable to determine the exact number of such cases because the two organizations use different classification schemes for complaints.

33.29 As provided for in the legislation, the Correctional Investigator exercises his discretion to be involved at the same time as Correctional Service because he has concluded that Correctional Service’s internal process does not always reasonably address the area of concern. Indeed, Correctional Service has been revising its grievance process due, in part, to concerns raised by the Correctional Investigator. In our opinion, however, some of this overlap may be unnecessary. The Correctional Investigator needs to address this overlap with Correctional Service as part of developing an overall strategy for managing the Office’s workload more effectively.

33.30 **The Correctional Investigator should improve the management of its workload by reducing the overlap between its complaints process and Correctional Service Canada’s internal grievance procedure, and by more clearly differentiating among the processes required to deal with different types of contacts.**

The Correctional Investigator Canada’s response: The Office accepts this recommendation and acknowledges current difficulties in managing our workload.

The Office has been aware for some time of the strain our intake process was placing on our resources. This became even more evident as we attempted, in line with the strategy detailed in the 1997-98 Main Estimates, to expand our participation in consultations with the Correctional Service on systemic areas of concern.

Accordingly, the Office has reduced telephone access on non-emergency matters and has taken steps to ensure a more consistent and frequent presence in the institutions to meet with inmates. Prior to the change in our telephone access policy, the Office was receiving 50 to 60 telephone calls per day. Guidelines for our intake process (initial contact) will be developed to provide a more standardized approach to decisions on categorization, referral and intervention in response to these contacts.

The Office's workload, in part, is determined by the effectiveness of Correctional Service's internal mechanisms for addressing inmate complaints. Although the Correctional Investigator has, in the past, been critical of the Service's inmate grievance process, recent improvements have been noted. This Office will continue to work with Correctional Service as it develops new policies and procedures related to this process, so as to co-operatively identify matters that are unnecessarily being referred to both organizations and an effective method of ensuring that the issues are addressed at the outset by the appropriate organization.

A communication strategy is needed

33.31 An ombudsman service is useful only if potential clients know of its existence. Given their intrinsic value, communications strategies have become an integral part of most ombudsman offices. Indeed, the Act directs the Correctional Investigator to maintain a program of communicating information to offenders concerning the function of the Office, the circumstances under which an investigation may be commenced and the independence of the Office.

33.32 A communication strategy serves two important purposes. The first is to "advertise" the service. The second is to explain the ombudsman's function to those for whom the service exists and to describe what his office can and cannot do. Clients' understanding of what is and is not possible reduces the potential for frustration. It could also reduce the volume of unnecessary requests and create some efficiencies.

33.33 So far, the Office has relied on the information provided in Correctional Service's induction package to inform inmates of its existence and its mandate. The package provides a brief explanation of the Correctional Investigator's role, including his independence from Correctional Service, and a phone number and address where he can be reached. In an attempt to inform the client base, the Office also sends its annual report to the inmate library in all Correctional Service institutions. It also seeks feedback on the annual report from a group of selected inmates.

33.34 As a way of promoting access and providing information, investigative staff try to visit each Correctional Service institution every six to eight weeks. During these visits, they meet with individual inmates as well as various inmate committees. For those inmates whose social skills, are severely limited, a face-to-face encounter is the only way they can raise their concerns with the Correctional Investigator. We noted that in the last few years, visits by staff to the institutions have not been as frequent as planned and have not been distributed equally among the institutions. Our consultation with some of the stakeholders in the criminal justice field suggests that maintaining inmates' access to the Correctional Investigator through staff visits needs to be assigned high priority.

33.35 We noted that corrections ombudsmen in other jurisdictions have gone further in their efforts to communicate. They recognize that the proportion of illiteracy and of learning disabilities among prisoners is significant and that not all inmates understand French or English. To meet this challenge, some of them have used videos and posters and distributed leaflets in languages other than English and French to reach the inmate population. Some have compared the profile of current users with the profile of the general inmate population as a way of identifying gaps in their service.

33.36 We feel it is important for an ombudsman such as the Correctional Investigator to ensure that his service is well known and accessible to all inmates who need it. It would be feasible for the Office to determine where there might be a need for a more directed approach to informing offenders of his mandate.

33.37 The Correctional Investigator should develop and implement an action plan for communicating the information necessary to facilitate access to his services and an understanding of his role.

The Correctional Investigator Canada's response: The Office is in complete agreement with the Auditor General on the importance of ensuring that the Correctional Investigator's service is well known and accessible to all inmates.

In conjunction with our increased presence at the institutions mentioned in response to recommendation 33.30, during these visits we will be meeting with inmate committees and any active inmate groups for the purpose of providing information on our role and how to access our service.

We have initiated a review of the material on the Office currently contained in Correctional Service's induction package to ensure that it reasonably and accurately details both our role and the method of accessing our services. We will begin discussions with Correctional Service on the feasibility of designing information packages that address the illiteracy, learning disability and language challenges identified in the chapter.

The Office is currently, in consultation with various inmate committees, developing an information package that will be posted at each federal correctional institution.

Complaints Investigation

33.38 The Act stipulates that the function of the Correctional Investigator is to conduct investigations into the problems of offenders. It has granted the Office full discretion over whether and how to conduct an investigation into these problems. Once the Correctional Investigator has decided to conduct an investigation, however, the Act is very specific on the requirement to conclude whether the problem exists or not (see Exhibit 33.3).

Exhibit 33.3

Legislative Scheme of the Correctional Investigator

1. investigates inmate problems that are related to decisions, recommendations, acts or omissions of Correctional Service personnel.
2. after investigation, concludes whether the problem exists or not.
3. a problem exists if:
 - a) the decision, act or omission of Correctional Service personnel:
 - appears to have been contrary to law or an established policy;
 - was unreasonable, unjust, oppressive or improperly discriminatory;
 - was based on a law, practice or policy that is or may be unreasonable, unjust, oppressive or improperly discriminatory; or
 - was based wholly or partly on a mistake of law or fact, or,
 - b) a discretionary power has been exercised:
 - for an improper purpose;

- on irrelevant ground;
- on the taking into account of irrelevant considerations; or
- without reasons having been given.

4. may make recommendations that:

- the Correctional Service give reasons to explain why the decision is made or the act or omission occurred;
- refer the Correctional Service decision, act or omission to the appropriate authority for further consideration;
- the Correctional Service decision be cancelled or varied;
- the Correctional Service act or omission be rectified; or
- the law, practice or policy be altered or reconsidered.

5. shall inform the Minister if adequate action is not taken by the Correctional Service within a reasonable time.

6. shall maintain a program of communicating information to offenders concerning

- a) the function of the Correctional Investigator;
- b) the circumstances under which an investigation may be commenced

33.39 According to the legislation, a problem exists when a decision, act or omission of the Correctional Service staff is contrary to a law or an established policy or is unreasonable, unjust, oppressive or discriminatory; or when a discretionary power is exercised improperly (see Exhibit 33.3 for details). In our opinion, this means that if the Correctional Investigator decides to intervene, he first needs to define the suspected problem. This is not only an important requirement for meeting the intent of the legislation but also a useful tool for identifying the root causes and developing remedies for systemic issues in the Correctional Service.

33.40 It is not easy to determine, as the Act requires, whether a decision or act of Correctional Service personnel was contrary to law or policy, or was unreasonable, unjust or oppressive. It is reasonable then, to expect the Correctional Investigator to have procedures and criteria to guide staff so that the Office has the ability to thoroughly and objectively investigate a wide spectrum of administrative actions.

Significant improvement needed in procedures for carrying out investigations

33.41 Our detailed review of 180 randomly selected files revealed structural weaknesses in the investigative process of the Correctional Investigator. We found that few written policies and procedures exist to help the investigators determine whether there really is a problem and what evidence is required to support that determination.

33.42 As noted earlier, many of the inmate contacts with the Office are inquiries for information or advice. The remaining cases are problems of various types that require different levels of intervention by the Correctional Investigator. During our file review, we noted that while investigators had classified each complaint by subject matter (such as transfer, inmate pay or temporary absence), the specific problem was not always identified.

33.43 Furthermore, we were not able to determine when and how the Office actually decided to investigate, and what the investigation entailed. This means that the time spent on a case can be more a reflection of the inmate's

ability and persistence in communicating his case than of the relative importance or urgency of the case. Consequently, there is a risk that similar inmate problems are being handled inconsistently.

33.44 We also noted significant delays in responding to some inmates' complaints. We were told that some delays were caused by difficulties in getting timely responses from Correctional Service. However, many were due to inadequate procedures within the Office. For example, our review revealed that 24 percent of the outstanding files had not been flagged for future action by a given date to ensure a speedy conclusion. Further, in half of the cases that did have "bring forward" dates, those dates were 12 months old.

33.45 The lack of written policies and procedures results in weaknesses in the thoroughness and responsiveness of the investigative process. In addition, the absence of a systematic approach to identifying the problem behind the complaints leads to a lack of data that could help flag systemic issues. Issues so identified could then be the subject of broad-based investigations to develop longer-term solutions.

33.46 **The Correctional Investigator should establish appropriate policies and procedures to guide the investigators in carrying out their work. Specific guidelines should be issued to determine when investigations should take place and how they should be conducted to meet the intent of the Act.**

The Correctional Investigator Canada's response: The Office accepts these recommendations and is in agreement with the Auditor General that steps be taken to provide greater consistency and efficiency both in identifying the point at which contacts or inquiries become a "problem" and in characterizing these "problems" in terms consistent with the provisions of the legislation. We also accepted that a clearer detailing of the areas of concern and the steps within our investigative process will assist in supporting both the identification of, and solutions to, systemic issues.

33.47 The Correctional Investigator should have in place procedures to support the identification of systemic issues.

The Correctional Investigator Canada's response: To guide the investigative process, the Office will develop written policies and procedures that reflect the requirements of the legislation and the operational realities of addressing inmate complaints.

Disputes with Correctional Service Canada mean lost opportunities for improvements

33.48 In ombudsmanship, two basic principles are paramount. First, an ombudsman's recommendations are not binding on the organizations he or she oversees. This feature is critical because it keeps the oversight body at arms length and prevents it from becoming just another level within the organization's administration. Second, recommendations made by an ombudsman must be feasible to implement and be based on evidence. The Act governing the Correctional Investigator reflects these principles.

33.49 The Correctional Investigator has at his disposal wide powers of investigation and unfettered access to Correctional Service information and facilities. Using these tools, he can establish the facts and present a case to Correctional Service management. Thus, the effectiveness of the Correctional Investigator reflects his ability to use these tools analytically and persuade Correctional Service to take reasonable corrective action.

33.50 We noted that some of the Office's recommendations have led, after many years of discussion, to substantive changes in certain policies and practices within Correctional Service Canada. On the issue of humanitarian temporary absences for inmates to attend funerals of family members, for example, the Correctional Service issued guidelines to clarify the intent of the policy. We also noted that Correctional Service has made some progress on such issues as investigations of "use of force" and procedures used to discipline inmates. Further, the

Correctional Investigator has participated in some of Correctional Service's reviews, such as those related to health care and the placement of offenders in administrative segregation.

33.51 However, it is clear from successive issues of the Office's annual reports that the Correctional Investigator and Correctional Service have had an adversarial relationship for a long time (see Exhibit 33.4). For the most part, their disputes centre on disagreement over Correctional Service's responses to what the Correctional Investigator has termed systemic issues, such as inmate pay, transfers and access to programming. In our opinion, it would be helpful if the two organizations could jointly establish a process for resolving and disposing of systemic issues so that opportunities to make lasting improvements to the system are not lost.

Exhibit 33.4

Continuing Disagreement between the Correctional Investigator and Correctional Service Canada

In 1992-93, the Correctional Investigator stated that the responses from Correctional Service's national headquarters were often "excessively delayed, defensive and non-committal".

In 1993-94, the Correctional Investigator noted that the majority of the issues detailed in the previous year's report had not been resolved.

In 1994, the Correctional Investigator invoked the applicable provision in section 180 of the Act and referred seven cases to the Solicitor General in an attempt to further pressure the Correctional Service to take action. The Commissioner of Correctional Service responded by reiterating the Service's position on each of the cases. Regarding the systemic issues, he argued that with such significantly different perspectives between the two agencies, it was very difficult to agree on what needed to be done next.

In response, the Correctional Investigator presented the following conclusion in his 1994-95 Annual Report: "The [Correctional Service] responses are defensive, display little if any appreciation of the history or significance of the issues at question, and provide at best a further string of promises of future action, with no indication as to expected results or how the results of these proposed actions will be measured or analyzed."

The Correctional Investigator further declared, in his 1995-96 Annual Report, "I have been singularly unsuccessful over the past few years, as evidenced by my previous Annual Reports, in causing a change in the Correctional Service's approach in dealing with matters raised by this Office."

33.52 When an adversarial relationship develops between an oversight agency and the government agency it oversees, it is conceivable that both bodies have played a role in its development. For example, Justice Arbour, in her inquiry into incidents at the Prison for Women, noted the Service's "demonstrated unwillingness" to accept the Correctional Investigator's conclusions. At the same time, based on our observations noted earlier, we believe that contributing factors include the overlap in the mandates of the two organizations and the structural weaknesses in the Office's investigative process.

33.53 **To reduce the potential for disagreement, the Correctional Investigator should, in co-operation with Correctional Service, attempt to establish a more effective process for resolving and disposing of systemic issues.**

The Correctional Investigator Canada's response: This Office and Correctional Service have commenced work on the development of a Memorandum of Understanding to clarify respective expectations in terms of content of communications, timeframe and methods of addressing disputes on facts, policy and law. It is hoped that this exercise will lead to a more effective process for resolving both individual and systemic areas of inmate complaint, and in turn, address some of the relationship issues identified in the Auditor General's Report.

It must be recognized, however, that even with the development of a more effective process, not all issues will be reasonably addressed. It must further be recognized, given the potential impact of administrative decisions within the correctional environment, that there is a need to ensure timely and responsive corrective action in instances of

illegalities and unfairness. As such, this Office continues to support, as detailed in our Annual Report, the establishment of a tribunal with the authority both to compel compliance with the legislation and policy governing the administration of the sentence and to redress the adverse effects of non-compliance.

Referral to the tribunal would occur in instances where this Office and Correctional Service have failed, within the provision of the existing legislation, to reach resolution on a significant issue related to the liberties and rights of inmates. As such, a tribunal would support and complement the function of this Office in ensuring that areas of inmate concern are decided on in an objective and timely fashion consistent with the provisions of the legislation.

Reporting Results

Database does not yield reliable statistics

33.54 The Office has a Complaint Tracking System that forms the database it needs to manage its operations and to measure and report its performance. From this database, the Correctional Investigator compiles statistics on workload and results, which are subsequently presented in his annual report to Parliament.

33.55 We reviewed the accuracy of data in a sample of cases to assess the reliability of the database. We found that the classification of cases according to their ultimate disposition was not consistent. For example, investigators had defined the term “resolved” and “not justified” differently. Our review also indicated that approximately 50 percent of the sampled cases had been classified and reported inaccurately. For example, a single complaint can be concluded initially as “premature” and counted once in the initial stage, and then be counted again after further intervention. These inaccuracies have occurred because the Correctional Investigator has not clearly defined what constitutes a complaint, what constitutes an inmate problem and precisely what each stage of the complaint-handling process entails. The cumulative effect of these deficiencies compromises the Correctional Investigator’s ability to provide useful information both for management purposes and for his annual report to Parliament.

33.56 The legislation requires the Correctional Investigator to submit a report annually to Parliament on the work of his Office. To make the information in it more meaningful, the Office needs to include a description of its objectives, the strategies used to attain those objectives, and the results achieved toward meeting the objectives.

33.57 We reviewed the Office’s previous annual reports, particularly those issued after the enactment of its legislation. A section of each report has provided statistics showing, for example, the number of cases received, by category and by institution, the number of interviews conducted, and the disposition of the cases. However, because the integrity of the database is questionable, we conclude that some of the statistics in the annual reports are not reliable.

33.58 We also believe that the results of the Office could be measured in a more meaningful way. For example, the statistics on the disposition of complaints could be separated from statistics on inquiries (see Exhibit 33.5). Further, the Office could report the results of its work in terms of the types of problems it has investigated and the extent to which they exist — such as the number of instances where it determined that an act or decision by Correctional Service was contrary to law — instead of referring only to the subject matter such as visits, case preparation, health care and so on.

Exhibit 33.5

(This exhibit is not available, see the Report)

33.59 We also noted that annual reports of other ombudsman offices have included indicators of efficiency, responsiveness, and effectiveness (see Exhibit 33.6). Further, their annual reports are generally more balanced in that they provide information about the operating constraints on the government organizations they oversee and on

the progress made over the years. In our opinion, including some of this information in the Correctional Investigator's annual report would improve the report's usefulness to Parliament.

Exhibit 33.6

Some Useful Indicators of Ombudsman Performance

- fairness indicators (for example, percentage of complaints unsubstantiated, total and by category)
- responsiveness indicators (for example, case turnaround time)
- effectiveness indicators (for example, percentage and number of findings and recommendations accepted by the department and improvements made to departmental policies and practices)
- level of client satisfaction (through various client feedback mechanisms)
- measures of its own compliance with standards (such as a fairness checklist)
- multi-year comparison of some or all indicators shown above
- case studies to exemplify typical and key problems encountered by inmates
- comments on underlying causes and on systemic weaknesses

33.60 The Correctional Investigator should review the quality and consistency of input to the Case Tracking System to improve the reliability of the information the system produces.

The Correctional Investigator Canada's response: The Office accepts both recommendations.

With respect to the quality and consistency of the input into the existing system, further staff training has been undertaken to again clarify the categories of complaints and the meaning of the dispositions. In addition, random quality control checks on the data will occur on a quarterly basis.

33.61 The Correctional Investigator should report results in a more meaningful way, such as separating complaints and inquiries in reporting disposition statistics, and developing some additional indicators of results for inclusion in the annual report.

The Correctional Investigator Canada's response: With respect to the improved reporting of results and the development of additional indicators of those results the Office, in consultation with other ombudsman operations at the federal and provincial level, will initiate a review to identify what information is required from both a management and reporting perspective and the best method of capturing that information, given resource and operational realities.

Conclusion

33.62 The objective of this audit was to assess whether or not the Office of the Correctional Investigator has been able to organize itself effectively to discharge its mandate. We noted that the Office started with a loosely defined mandate under the *Inquiry Act* in 1973. It has since accumulated a set of practices that had not been subjected to any kind of review prior to our audit. We found that while these practices are often helpful in resolving individual complaints, they are not conducive to efficient and consistent handling of cases and have contributed to its adversarial relationship with Correctional Service Canada.

33.63 The Office operates in an environment where demand for its service is incessant and its relationship with Correctional Service Canada needs careful balancing. Our audit has led us to conclude that the Office needs to improve its strategies, policies and practices in order to effectively manage its workload, communicate with inmates, investigate inmates' problems thoroughly, and maintain a balanced relationship with Correctional Service.

33.64 Although we call attention to a number of problems in the organization, we would emphasize that the Office plays an important role in ensuring fairness for those serving sentences and in reducing the potential for unrest in Canada's prisons. The problems we have noted can and should be fixed so that the Office of the Correctional Investigator can better play its role within the Canadian criminal justice system.

***Correctional Investigator's general comments:** Chapter 33 of the Auditor General's Report provides both a detailing of this Office's operations and an overview on the role of an ombudsman. The chapter emphasizes the importance of our role as an ombudsman for federal inmates and offers a series of practical and well-focused recommendations that will assist this Office in better fulfilling its mandate within the Canadian criminal justice system.*

There are two factors that, although beyond the scope of the audit, we believe need to be noted in reviewing the chapter's observations and recommendations.

First is the public reporting feature common to all ombudsmen. It is public reporting, especially in areas where resolution with the government agency has not been achieved, that provides the ombudsmen with a recourse to ministerial, parliamentary and public consideration of their findings and recommendations. This external consideration of issues, given the non-binding aspect of the recommendations, is central to an effective ombudsman operation. This matter is raised to emphasize that the responsibility for the resolution of issues, especially within an environment like corrections, does not rest solely with the government agency and the ombudsman.

Second is the Office's resource base. The Auditor General notes that this is a small agency with a small budget. The chapter further notes that the demand for our services is incessant and that our areas of responsibility expanded with the introduction of the Corrections and Conditional Release Act in 1992. In addition, both the inmate population and the number of federal correctional facilities have increased measurably during this time period. There has been no adjustment of our resource base since 1992.

About the Audit

Objective

The objective of our audit was to determine whether the Office of the Correctional Investigator has adequately organized itself to fully carry out its mandate. We focussed on the practices that the Office has established to fulfil its mandate and on the way it manages its operations, measures its performance and reports its results.

Scope

The scope of our audit included all aspects of the Correctional Investigator's operations, from the intake of complaints to informing Parliament of the results. It did not include a review of Correctional Service, other than the Office's dealing with the Service in the complaint process.

Criteria

We expected to find that the Office:

- has an appropriate accountability framework;
- has mechanisms to facilitate the discharge of its mandate;
- manages its operations efficiently; and
- has in place systems and procedures to measure and report its performance.

Audit Team

Jayne Hinchliff–Milne
Patricia MacDonald
Jocelyne Therrien

For information, please contact Robert W. Chen, the responsible auditor.

Chapter 34

RCMP Public Complaints Commission

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RCMP Public Complaints Commission

Assistant Auditor General: Maria Barrados

Responsible Auditor: Robert W. Chen

Main Points

34.1 The RCMP Public Complaints Commission is responsible for reviewing public complaints about the conduct of members of the RCMP. Although its budget is small (\$3.5 million), the Commission can, through its reviews, enhance the transparency of the complaint process and help the RCMP to improve its policing practices.

34.2 Although the Commission has articulated the need to develop and implement a communications strategy, it has yet to finalize its plan for informing Canadians about their right to request a review if they are not satisfied with the RCMP's disposition of their complaints.

34.3 The Commission's handling of complaint reviews and public hearings is slow. It needs to improve the way it works by streamlining the review process and providing appropriate training to Commission members who are responsible for conducting public hearings.

34.4 The Commission also needs to improve its performance measures. Although useful statistics are provided in its annual report, they are often incomplete or inconsistent. The Commission needs to renew its effort to provide a fuller picture that demonstrates both its contribution to the public complaints process and the overall effectiveness of that process.

Introduction

34.5 The RCMP is Canada's federal police force. It is also contracted to serve as the police force for all provinces (except Ontario and Quebec), the two territories, and nearly 200 municipalities. About 50 percent of its members are engaged in provincial and municipal policing. These activities bring them into contact with the public more often than does their federal law enforcement work. It is in these policing activities, then, that members of the Force are more likely to be the subject of complaints.

34.6 The RCMP Public Complaints Commission is an important institution in our democratic system. It has been established by Parliament to ensure that members of the RCMP, who are given special authority and power under the law, are properly accountable to the public for their conduct.

34.7 Before September 1988, anyone wishing to complain about the conduct of a member of the RCMP had to lodge the complaint with the Force itself. If not satisfied with the RCMP's disposition of the complaint, the complainant's only recourse was to seek redress through the courts.

34.8 Two major reports - the Marin Report (1974) and the McDonald Report (1977) - identified as a weakness the lack of an independent authority to review the actions of the RCMP in handling public complaints. The need for independent review was apparent given the perceived difficulties of having the RCMP itself investigate allegations of improper conduct by its own members. The Force could not be both the supervisor of its members and the final arbiter of complaints against them. Both reports suggested that complainants and RCMP members involved in complaints were entitled to the unqualified confidence in the RCMP that could be provided by an external body with the power to review allegations of improper conduct by members of the Force.

34.9 In the 1970s, a number of provincial governments had established police commissions to oversee the handling of public complaints about police conduct. That move was based on the principle that the special power of the police over members of the public needs to be balanced with the impartial and fair review of complaints by an independent, civilian body. The civilian body would thereby strengthen the accountability of the police force to the community, which would strengthen public confidence and, ultimately, improve policing practices.

The focus of the Commission's mandate is independent review

34.10 The RCMP Public Complaints Commission was established by the *RCMP Act* and became operational on 30 September 1988. It was created to receive complaints and provide a process for the external and independent review, investigation and hearing of complaints about the conduct of RCMP members in the performance of their duties.

34.11 The complaints process consists of three stages: receipt of complaints and investigation by the RCMP; review and investigation, if necessary, by the Commission, if the complainant is not satisfied with the RCMP's disposition of the complaint; and a hearing by the Commission if the Chairman concludes that a hearing is desirable.

34.12 Members of the public can initiate complaints by contacting the Commission; or a provincial authority responsible for receiving and investigating complaints about the police; or the RCMP itself. A complaint received by the Commission or by provincial authorities is forwarded to the RCMP, which is responsible for the initial investigation of all complaints. If the complainant is not satisfied upon notification of the RCMP disposition, he or she may refer it to the Commission for review. The workload of the Commission for the last three fiscal years, excluding public hearings, is shown in Exhibit 34.1.

Exhibit 34.1

Number of Complaints and Requests Received by the Commission

	Complaints Received by the Commission	Complaints Received by the RCMP	% Complaints Received by the Commission	Requests to the Commission for Review
1994-95	919	2,212	41.5%	231
1995-96	1,018	2,592	39.3%	308
1996-97	1,002	2,384	42.0%	299

Source: The Commission's Annual Reports

34.13 In addition to reviewing complaints referred to him, the Chairman of the Commission has discretion under the Act to initiate his own complaint, if he believes there are reasonable grounds for investigation. The legislation also gives the Chairman discretion, in the "public interest", to investigate any complaint or to institute a hearing, whether or not the RCMP has handled the complaint.

34.14 After a review or a hearing, a report is prepared setting out the Commission's findings, and its recommendations when it is not satisfied with the RCMP's disposition. The report is sent to both the Commissioner of the RCMP and the Solicitor General. The Commissioner must review the complaint in light of the report and notify the Commission and the Solicitor General as to what further action will be taken. If the Commissioner decides not to act on the Commission's report, he must provide the Commission and the Solicitor General with reasons.

34.15 The Chairman of the Commission then prepares a final report and sends it to the complainant, the member of the RCMP whose conduct is in question, the Commissioner of the RCMP and the Solicitor General. On occasion, a party to a complaint will seek further action through the courts, notify the media, or bring the matter to the attention of the Solicitor General or Parliament.

34.16 If the Chairman agrees with the way the RCMP has disposed of the complaint, a "satisfied" report is sent to the complainant, the involved member, the Commissioner and the Solicitor General.

The Commission reviews a variety of public complaints

34.17 While each complaint is important to the individual complainant, the Commission reviews complaints of varying degrees of seriousness. There have been complaints about RCMP members having a "poor attitude" -- being curt or discourteous; others have alleged that the RCMP used excessive force or that the complainant was assaulted while in police custody. For example, a man complained that a member used excessive force during his arrest and when putting him into a cell at the RCMP detachment. The member stated that the man had been drinking and had become confrontational. After the RCMP disposed of the complaint, the complainant referred the case to the Commission for review. The Commission found that while the officer had used reasonable force during the arrest, the use of force at the detachment was improper. The Commission recommended that the member apologize to the complainant.

34.18 Sometimes, however, complaints may link the misconduct of individual members to weaknesses of a systemic nature, such as a lack of training or inadequate policy. In these cases, the Commission may recommend that the RCMP address the systemic weaknesses. While the Commission's recommendations are not binding, the RCMP has accepted and implemented many of them in order to improve its policing practices.

34.19 For example, a man complained that a member had not conducted an adequate investigation into the alleged sexual assault of his daughter. The Commission recommended that the member involved in the complaint receive further investigative training and that a divisional policy be developed, governing the videotaping of child witnesses in sexual assault complaints. In response, the RCMP has committed itself to rewriting its national policy in this area.

34.20 As this example illustrates, the relationship between the Commission and the RCMP can lead to positive results. We were informed that it can also create tensions: members of the Force sometimes believe that the Commission's reviews second-guess their work and prevent them from getting on with their job of protecting Canadians. RCMP management has occasionally perceived the Commission as interfering with its internal management. However, external review can give rise to a healthy "creative tension" that can lead to greater police accountability to the public and to improvements in policing services.

Organization and resources

34.21 The Commission has a budget of \$3.5 million, of which approximately \$2 million represents salaries and benefits. Other than salaries, the largest operating expense is for professional and special services.

34.22 The Commission's Chairman is appointed by order of the Governor in Council as a full-time member. As well, part-time members are appointed to represent the provinces and the two territories policed by the RCMP. The Commission is supported by 33 full-time staff in three offices.

34.23 The Commission's head office is located in Ottawa. It has regional offices in Vancouver and Edmonton. Although complaints from the public are received in the three offices, they are all reviewed by the Ottawa office.

Focus of the audit

34.24 Our aim was to determine whether the RCMP Public Complaints Commission has adequately organized itself to discharge its mandate. We focussed our examination on the Commission's systems and practices for carrying out its mandate, managing its operations, measuring its performance and reporting its results. Details on our audit scope and criteria can be found at the end of the chapter, in **About the Audit**.

Observations and Recommendations

Mandate and Planning

The Commission has established systems and practices to fulfil its mandate

34.25 The *RCMP Act* sets out clearly the mandate of the Commission and delineates the respective roles and responsibilities of the Commission and the RCMP in the public complaints process.

34.26 During our audit, we interviewed senior management and operational personnel. We also reviewed policy and procedural manuals, minutes of the Management Committee, operational plans and budgets, annual reports and other relevant documents, such as the Mission Statement, to assess the extent to which the Commission has fulfilled its mandate.

34.27 We noted that over the years the Commission and the RCMP have resolved a number of important mandate and legal issues, either through the courts or by administrative agreements. Two key issues remain to be resolved -- disclosure to complainants and the Commission of the specific discipline imposed on RCMP members for an act of misconduct, and publication of the Commission's final reports. The Commission is pursuing the resolution of these issues.

34.28 The Commission's systems and practices are described in its various manuals. For example, the Complaints Policy and Procedures Manual clearly delineates the roles and responsibilities of the Chairman and his staff with respect to the complaints procedures and review process.

34.29 The Commission's responsibilities include informing the public of its existence and function, receiving complaints, reviewing RCMP dispositions referred to it by dissatisfied complainants, initiating and conducting public hearings, and making recommendations to effect positive changes in RCMP policing practices.

34.30 Although the Commission has generally established systems and practices to fulfil its mandate, it does not have in place an approach to planning that directs its efforts to priority areas. Our review revealed that the Commission has set out a mission statement and defined its goals and priorities in its planning documents. Plans used for internal purposes are the same as those set out in Part III of the Estimates. In areas requiring specific attention, more detailed action plans are required. During the course of our audit, we identified two areas for which no plans with specific actions had been developed to address initiatives set out in Part III -- receipt and review of complaints in a timely fashion, and improving communications to inform the public about the Commission's existence and mandate.

A communications strategy is needed

34.31 From the beginning of its operation, the Commission recognized that "the right to a review is of no value to a person who is not aware of that right." The Commission has conducted several studies to identify communications factors that need to be addressed. One study found that the use of RCMP at the beginning of its name invites, and indeed has created, a public perception that the Commission is part of the RCMP rather than an independent body. Its name in French -- la Commission des plaintes du public contre la Gendarmerie royale du Canada -- has not caused such difficulty. Another study found that it is confusing for residents of a province to have two different public complaints systems and two different external review bodies -- one for the RCMP and one for local police forces. A third study pointed out the diversity of the Commission's constituency and hence the corresponding need for a multi-pronged communications approach.

34.32 However, after several attempts over the last five years, the Commission still does not have a communications strategy that defines specific actions to address these concerns.

34.33 A 1995 study conducted for the Commission by Statistics Canada revealed that while 70 percent of the complainants surveyed were aware that the Commission was a separate organization, only 21 percent realized that it was independent of the RCMP. We believe that the failure to develop and implement a communications strategy to inform the public about its role as an independent, civilian oversight body is an important factor in this misconception.

34.34 **The Commission should develop a communications strategy to improve public awareness of its existence and mandate as well as its independence from the RCMP.**

Commission's response: The RCMP Public Complaints Commission is in full agreement with this recommendation. The Commission has developed three draft communications plans and strategies over the past five years but has not yet approved a plan and strategy. The Commission undertakes to produce a communications plan and strategy by March 31, 1999.

It should be recognized that the term of the Commission's Chairman for the past five years has expired and that it will take the new Chairman some time to become fully cognizant of the operations and activities of the Commission. As a result, some time must be provided to allow for this familiarization process.

Review of Public Complaints

The review process is slow

34.35 The Commission has a Complaints Policy and Procedures Manual. This is an important tool to ensure that all complaints referred to the Commission for review are handled in a fair and consistent manner. Our examination of selected files and observations of the complaints review process indicated that the Commission has, indeed, handled complaints in accordance with the prescribed procedures (see paragraph 34.11).

34.36 The 1995 Statistics Canada survey revealed that 75 percent of complainants and 69 percent of RCMP members surveyed said the Commission's reviews took too long. In its annual report, the Commission reported that in 1995-96 the average turnaround time to complete a complaint review, in cases where the Commission agreed with the RCMP's disposition, was about 160 days. In cases where it disagreed with the RCMP, the turnaround was about 340 days. Both results exceeded the Commission's own objective of a 90-day turnaround. The Commission has since changed this target to a 120-day turnaround.

34.37 In the past when the volume of complaints requiring review increased and the turnaround time increased in turn, additional staff were brought in on a temporary basis. This improved the Commission's turnaround time but did not eliminate the backlog. Given the lack of a strategy and supporting actions to improve the situation under the current approach, backlogs are again increasing. A recent internal report also indicated that the Commission's backlog had increased to about 400 cases, equivalent to more than its yearly workload. Our audit identified opportunities to streamline the review process and improve turnaround time.

34.38 For example, the quality control mechanism that the Commission uses could be simplified and streamlined. Because the Chairman signs all Commission reports, each report goes through a multitude of quality controls, including the Complaints Review Committee. Consequently, the process is time-consuming. An internal audit report highlighted this weakness and made certain recommendations that the Commission has implemented to simplify and streamline the function of its Complaints Review Committee. However, we observed that the Committee continues to spend a large amount of time reviewing the quality of each report and debating issues that have been settled previously in similar cases.

34.39 The Commission has recently installed a report retrieval system that contains all details of each complaint it has reviewed, including findings and recommendations. While the system can be used to access "precedent" cases, the Commission's staff have yet to be trained to use it to ensure that similar complaints are handled in a consistent way. This also suggests a missed opportunity to streamline the process and shorten the time required to complete reviews.

34.40 **The Commission should investigate ways and means of improving its turnaround times, including streamlining its review process and training its staff in the use of the report retrieval system.**

***Commission's response:** The RCMP Public Complaints Commission agrees with the recommendation. While the Commission has been aware that its process can be slow, it has, over the years, continually been working to speed up the process. In the Commission's Part III Estimates for 1997-1998, the Commission indicated its concern about turnaround time in the review of complaints and undertook to reduce the time it takes to process final reports by 30 days over the next three fiscal years. The Commission undertakes to continue this initiative on a year-to-year basis so as to further reduce the turnaround time.*

In respect of the report retrieval system, the Commission undertakes to provide instruction on its use for the newer staff at the Commission and to provide a refresher course to staff who have been with the Commission for a longer period of time.

Public hearings in the “public interest” require terms of reference

34.41 The Chairman has the legislative authority to institute a public hearing either as part of a regular review or in the “public interest”. The Commission told us that a hearing that is part of a regular review generally focusses on a specific complaint. However, a hearing in the public interest can cover issues that underlie or are related to the misconduct in question, in addition to the specific complaint.

34.42 Since its inception in 1988, the Commission has held 16 hearings, 11 of which were in the public interest. Public hearings provide a window into the RCMP’s operations and an opportunity to strengthen accountability to the community. This is in keeping with the goal of independent, civilian oversight. However, hearings are time-consuming and costly. The Commission’s longest public hearing took almost four years to complete, and the most expensive one, to date, has cost the Commission more than \$600,000.

34.43 The RCMP, which is always a party to hearings, has been critical of the way public interest hearings have been conducted. In its comments on a recent hearing, the RCMP said that the Commission’s hearing panel “allowed irrelevant testimony, irrelevant witnesses, unsupported allegations of unrelated incidents and discussions to be presented.” Our interviews with panel members, counsel and Commission staff revealed similar concerns.

34.44 While it has been criticized for “taking too much time to complete a hearing”, the Commission needs to continue hearing important issues of public interest in order to fulfil its mandate. However, we believe that to do so the Commission needs to significantly improve the way it carries out public hearings, both by prescribing clear and precise terms of reference for each hearing and by providing its members with training in conducting hearings.

34.45 As we have noted, the Chairman has the power to call hearings in the public interest. The Commission’s position is that the decision to call a public hearing will be based on the Chairman’s judgment after careful consideration of the case. We noted that the Chairman’s reasons for calling hearings have not been recorded and routinely provided to hearing panel members. As a result, public hearings have been initiated and carried out without terms of reference or criteria establishing the public interest to be considered. Our review of hearing files confirmed the absence of terms of reference. Hearing panel members and other parties to hearings have also indicated that they are concerned about this issue.

34.46 A working group established in 1995 to review the *RCMP Act* proposed an amendment that would require the Chairman to identify the public interest concerns when instituting a public hearing. It pointed out that such a requirement would be helpful to all parties in preparing for hearings. A more focussed hearing would be less time-consuming and therefore less costly. While waiting for proposed legislative changes, the Chairman has the power to consider administrative measures to set out the terms of reference for hearings.

34.47 **The Chairman of the Commission should set out clear and precise terms of reference for hearings in the public interest.**

Commission’s response: This recommendation [had to] be discussed by the members of the Commission in order to prepare a response. That discussion [was] to be held October 29 to 31, 1997. A response to this recommendation [was] then [to] be prepared by the Commission.

Commission members need training in conducting public hearings

34.48 Commission members are appointed by order of the Governor in Council. The Commission has no formal input to the selection of members. We note that most members have a legal education, but not necessarily experience in conducting public hearings. To conduct and manage public hearings effectively, they need a good knowledge of administrative law and a sound understanding of rules and procedures, given that these proceedings often involve many interested parties and complex legal arguments.

34.49 Despite this, members of the Commission who may be assigned to public hearings receive no formal training in conducting these hearings. Although members have indicated that they need training, the Commission has cited the lack of funds as a reason for not providing it.

34.50 In recent years, demand has been increasing for appropriate training for Governor in Council appointees who are responsible for conducting public hearings. As a result, the federal government has established a three-phase training program to provide tribunal members with a sufficient level of knowledge and skills to conduct public hearings. Although the Commission is aware of this training program, and its legal counsel is one of the instructors, no members have attended it.

34.51 **The Commission should ensure that its members receive the appropriate training before they are assigned responsibility for conducting public hearings.**

Commission's response: This recommendation [had to] be discussed by the members of the Commission in order to prepare a response. That discussion [was] to be held October 29 to 31, 1997. A response to this recommendation [was] then [to] be prepared by the Commission.

Measuring and Reporting Results

34.52 The Commission has put in place a Complaints Tracking Database, which contains, among other things, specific descriptions and key dates of every complaint that comes to the Commission for review. The Commission can use the database to determine its workload volume and calculate its turnaround time for reviews. While these are useful statistics, we have a number of concerns about the meaning and accuracy of these measures of results.

The Commission needs to improve the measurement of its turnaround time

34.53 Our review of the database itself revealed that many key dates in the review process had either not been entered or had been entered incorrectly. The published turnaround time differed from figures in the Commission's working papers. There was no explanation for this inconsistency. As a result, statistics on turnaround time drawn from the database are of uncertain reliability. We are concerned that the Commission has not approached its measurement of turnaround time from the perspective of complainants. The Commission counts only the time from the day it receives all relevant material from the RCMP to the day on which the Chairman issues his final report -- less any time outside its control, such as time spent waiting for the RCMP Commissioner's responses to the interim reports.

34.54 While this figure may be useful for the Commission's internal purposes, it is not a reasonable measure from the perspective of complainants. For them, the clock begins to tick when they ask the Commission to review their cases, if not when they lodge the complaints initially. Their satisfaction, or lack of it, depends on their judgment about the overall length of time taken to get a resolution. They are not interested in whether any delays are caused by the Commission or by the RCMP.

34.55 Our present analysis of the data from the database indicates that the amount of time not included in the Commission's current definition of turnaround time is significant. Including it would add up to another 90 days to the present average, which still excludes the time between the date when the complaint is lodged and the date when the Commission is asked to review it.

34.56 Furthermore, we found that the database has not been used to produce routine reports, such as turnaround time for its reviews and the volume of its backlog. When the Commission needs these reports, it has to make a special effort to extract data and tabulate the statistics.

34.57 The Commission should:

- **improve the quality of data in its Complaints Tracking Database;**
- **develop better measures of the turnaround time for complaint reviews; and**
- **strengthen the report-generating capacity of the Complaints Tracking Database.**

Commission's response: The Commission is in complete accord with this recommendation. However, it would like to point out that over the past ten months there has been a high turnover in the operations branch of the Commission including both officers and support staff. The reliability of the Complaints Tracking Database (CTD) has been the unfortunate victim of this situation. As the personnel situation becomes more stable, the Commission will be making every effort to ensure that the information in the CTD is more reliable.

The Commission also undertakes to establish a measure more relevant to both complainants and RCMP members for calculating the turnaround time for complaint reviews. However, it should be noted that when the complainant and the RCMP member(s) receive the Commission's final report, the following dates are always provided to them:

- *the date the complaint was received;*
- *the date of the RCMP's letter of disposition;*
- *the date the request for review was received by the Commission; and*
- *the date the relevant material was received by the Commission.*

While there are several existing reports that have been created to report specifically on the time spent in each stage by each request for review, in the last year or so these reports have not been generated on a regular basis. The Commission undertakes to generate existing reports on a more regular basis, as well as to create other reports that will provide regular information on the backlog of the Commission, among other things.

A consistent approach is essential in reporting results

34.58 According to the *RCMP Act*, the Commission has two levels of accountability. It is required by legislation to inform the parties to each complaint of the result of its review. On a summary basis, it is also required to submit to Parliament, through the Solicitor General, an annual report on its activities.

34.59 During our audit, we noted that the Commission has established procedures to ensure that the Chairman's reports are sent to parties to the complaint at each stage of the review process, as required by legislation. The Commission has also submitted its report to Parliament annually. All reports are similar in content and structure.

Each provides a summary of the Commission’s activities, details of some sample complaints together with review findings and recommendations, and a general discussion of the effect of the Commission’s work. In our opinion, these descriptive sections of the report are informative, and useful for accountability.

34.60 The Commission has also included some statistical details in its annual reports to describe the results of its work. Although these statistics provide additional concrete information for accountability purposes, we have concerns about the reliability of the information and usefulness of the results provided.

34.61 The Commission measures its impact on the RCMP in terms of the extent to which its recommendations have been accepted. It has reported that the Force has accepted about 80 percent of its recommendations. Although we have observed changes in RCMP policies and procedures as a result of the Commission’s recommendations, we could not confirm all the statistics in this area. As reported in paragraph 34.53, measures of turnaround time drawn from the Complaints Tracking Database are of uncertain reliability.

34.62 We were informed that a complaint may contain one or more allegations. Each allegation is examined on its own merit. In disposing of a complaint, the RCMP may support one allegation in a complaint but may not support another. At the same time, in reviewing a complaint the Commission may be satisfied with the RCMP’s disposition of one allegation, while it may not be satisfied with another. Therefore, a common approach or framework for reporting the outcomes of RCMP investigations and Commission reviews is essential.

34.63 The RCMP and the Commission have been using a common reporting approach since 1993 for classifying allegations. We found that the RCMP is able to provide statistics on its disposition of all allegations it has investigated (see Exhibit 34.2). However, the Commission does not report the results of its reviews of allegations. It reports only on its review of complaints, which may contain any number of allegations. Consequently, it is difficult to assess the contribution of the Commission in adding fairness to the overall process (that is, how often the Commission found an allegation to be substantiated that the RCMP had not) and in identifying systemic problems in RCMP policing practices (that is, the type of allegation most often found by the Commission to be substantiated).

Exhibit 34.2

Disposition of Allegations Investigated by the RCMP

Allegation Classification	1994 RCMP Statistics			
	Total	Withdrawn	Unsupported	Supported
Improper Attitude	915	51	653	211
Improper Use of Force	560	35	501	24
Improper Use of Firearms	24	1	23	0
Irregularity in Procedure	442	30	356	56
Driving Irregularity	86	2	59	25
Neglect of Duty	715	38	591	86
Statutory Offences	240	5	216	19
Mishandling of Property	66	3	54	9
Irregularity - Evidence	51	1	48	2
Oppressive Conduct	498	22	435	41
Improper Arrest	216	17	190	9
Improper Person/Vehicle Search	58	4	47	7
Improper Search of Premises	89	15	59	15
Policy	72	6	51	15
Equipment	25	1	17	7
Service	176	15	142	19

Total	4,233	246	3,442	545
Percentage		5.8%	81.3%	12.9%

Source: Internal Affairs Branch, RCMP

34.64 Parliament needs fair and reliable information in order to assess the overall results and effectiveness of the public complaints process that it established in 1988.

34.65 For its report to Parliament the Commission should improve the reliability of the information and provide more information on the results of its handling of allegations.

Commission's response: The Commission supports this recommendation. In fact, steps have already been taken to collect this information within the Commission. The Commission will consider the development of other reports on its review of the RCMP disposition of public complaints so as to provide more information that could help it to assess the contribution of the Commission in the public complaints area.

Conclusion

34.66 We found that from the time it first began operations in September 1988, the Commission had established systems and practices to fulfil its mandate. However, we observed a number of areas in its management practices that need to be strengthened. The Commission needs a communications strategy to improve public awareness of its existence, mandate and independence. It also needs to develop specific action plans to address the issues we identified in its processes for reviews and public hearings, in order to respond to parties to complaints in a more timely manner. Finally, it needs to improve measures of performance in order to provide fair and reliable information on the results of its activities.

Commission's comments: The chapter provides a clear outline of the operations of the RCMP Public Complaints Commission. It recognizes the complexity of the process for the receipt and review of complaints as set out in Part VII of the RCMP Act. It also indicates the importance of an independent civilian oversight of the handling of public complaints as a means of ensuring the accountability of the police to the community. The chapter illustrates the range of police conduct that might be the subject of a public complaint and that complaints might deal with weaknesses of a systemic nature, as well as the individual conduct of members of the RCMP. The fact that a "creative tension" might exist between the RCMP and the Commission is seen as a healthy situation that can be expected to exist in a civilian oversight relationship.

The chapter provides pertinent and practical recommendations to improve the strategic planning of the Commission, as well as the gathering and reporting of information on the complaint review process and its results. Some of its recommendations raise issues about the conduct of public hearings of the Commission and the training of Commission members in respect of holding such hearings. The RCMP Act is abundantly clear in matters having to be addressed by members of the Commission as defined in subsection 45.29(1). According to section 45.33, it is the Commission that makes the rules respecting the manner of dealing with matters before it. Therefore, it is the Commission members who must consider those recommendations as they relate to public hearings and training. As a result, these issues [were] put on the agenda for the Annual General Meeting of the Commission ... held October 29 to 31, 1997.

As is mentioned in the Introduction to the chapter, the Commission is very small and has limited resources. As its main activity is the review of complaints that have been investigated and disposed of by the RCMP, most of its finances are devoted to that activity. The costs involved in carrying out some of the recommendations in the chapter could put a strain on the financial resources involved in carrying out the review activity, particularly the training of the members. Nevertheless, the Commission will do all it can to respond in an active manner to the recommendations in the chapter.

About the Audit

Objective

The objective of our audit was to determine whether the RCMP Public Complaints Commission has adequately organized itself to fully carry out its mandate. We focussed on the practices the Commission has established to fulfil its mandate, and on the way it manages its operations, measures its performance and reports its results.

Scope

The scope of our audit included all aspects of the Commission's operations, from receiving complaints to informing Parliament of the results. It did not include a review of the RCMP, other than the Commission's dealings with the RCMP in the public complaint process.

Audit Criteria

We expected to find that the Commission:

- has an appropriate accountability framework;
- has mechanisms to facilitate the discharge of its mandate;
- manages its operations efficiently; and
- has systems and procedures for measuring and reporting its performance.

Audit Team

Jayne Hinchliff Milne
Patricia MacDonald
Jocelyne Therrien

For more information, please contact Robert W. Chen, the responsible auditor.

Chapter 35

Follow-up of Recommendations in Previous Reports

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Follow-up of Recommendations in Previous Reports

Main Points

35.1 Progress toward addressing our recommendations contained in previous reports is noted in each of the follow-up segments included in this chapter. However, in most cases, additional work is needed to deal with the recommendations satisfactorily. For example, Natural Resources Canada has taken steps in the right direction, such as the development of a policy framework for radioactive waste. However, much remains to be done to find long-term solutions for Canada's nuclear fuel waste, low-level radioactive wastes and uranium mine and mill tailings.

35.2 The following significant areas of concern remain:

- Five years after noting our concerns, much remains to be done to ensure that Canada is prepared for major oil and chemical spill emergencies.
- Parliament continues to need adequate information on the risks and clean-up costs of federal contaminated sites. While some progress has been made, environmental liabilities are likely quite substantial and could materially affect the government's reported financial condition.
- The issues reported in this chapter and in Other Audit Observations, Chapter 36, regarding on-reserve facilities funded by Indian and Northern Affairs Canada, continue to raise concerns about the Department's cost effectiveness in addressing on-reserve needs. These concerns involve deficiencies in project planning, implementation, evaluation and related matters.

35.3 In some cases, downsizing has resulted in many changes to programs delivered by federal government departments and agencies. We have noted several delays in addressing our recommendations as a result of program changes.

35.4 In two cases included in this chapter, the departments concerned performed studies or reviews in response to our recommendations, but corrective action is yet to be implemented.

35.5 We encourage departments and agencies to continue addressing our concerns through further corrective action.

Introduction

35.6 An integral part of our audit cycle is to review the actions taken by departments in response to observations and recommendations made in our reports and by parliamentary committees.

35.7 Our purpose is to report to Parliament on the progress made until corrective action has been implemented or more recent events make further action unnecessary.

35.8 Follow-up does not provide the same high level of assurance as an audit. Rather, it provides a moderate level of assurance that departments have acted on our recommendations, unless we note otherwise. This assurance is based on information obtained from interviews with departmental officials, document reviews, and other evidence to allow us to conclude on the plausibility of the information provided to us.

35.9 We normally follow up on observations and recommendations and report on their status two years after we publish our original chapter. Some follow-up activity is reported as a separate chapter or reported with subsequent audits of departments, or grouped to provide an overall measure of progress on numerous recommendations, such as in Chapter 18 of our October 1997 Report — Revenue Canada and Department of Finance. Exhibit 35.1 provides a list of audits due for follow-up that are not included in this chapter.

35.10 This chapter reports on progress toward implementing our recommendations made in audits conducted between 1992 and 1995. All the follow-up reports note that progress has been made toward addressing our recommendations, and in some cases they have been fully implemented. But a large number also report that further work needs to be done before the recommendations have been dealt with satisfactorily. In some cases, the delays have been attributed to program changes, but in other cases there is no obvious reason for the delays.

Exhibit 35.1

Chapters Due for Follow-up That Are Not Included in This Chapter

Year & #	Chapter Title	Responsible Auditor	Follow-up Status
1992			
24	Emergency Preparedness in the Federal Government	Alan Gilmore	Portions of the chapter are being followed up in a phased approach: S Preparedness for Major Earthquakes - Reported in Chapter 26 of the November 1995 Report S Nuclear Emergencies Planned for follow-up in 1998 S Accidents involving Oil and Chemicals - Reported in this chapter
1993			
19	Department of National Health and Welfare - Non-insured Health Benefits	Ellen Shillabeer	Reported in Chapter 13 of the October 1997 Report
20	Revenue Canada - Advance Income Tax Rulings, GST Rulings and Interpretations	Barry Elkin	Reported in Chapter 18 of the October 1997 Report
22	Department of Transport - Airport Transfers	Hugh McRoberts	Deferred from 1995 as no further transfers had been made to airport authorities. To be included in a new chapter, tentatively planned to report in 1999.
1994			

Year & #	Chapter Title	Responsible Auditor	Follow-up Status
10	Science and Technology - Management of Departmental Science and Technology Activities	Richard Flageole	Deferred, as the government will be implementing its new strategy on Science and Technology. Tentatively planned to report in 1998.
11	Science and Technology - The Management of Scientific Personnel in Federal Research Establishments	Jacques Goyer	Portions of the chapter are being followed up in a phased approach: S The overall human resources management framework was followed up in Chapter 15 of our September 1996 Report. S The remaining portion has been deferred, as the government will be implementing its new strategy on Science and Technology. Tentatively planned to report in 1998.
12	Aspects of Federal Real Property Management	Reno Cyr	Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. Tentatively planned to be combined with an audit of this area planned to report in 1999. See Chapter 34 below.
18	Correctional Service Canada - Supervision of Released Offenders	David Brittain	Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.
22	Foreign Affairs and International Trade Canada	John Hitchinson	Reported in Chapter 9 of the April 1997 Report.
28	Revenue Canada: - Customs Assessment Activities	Jim Ralston	Reported in Chapter 18 of the October 1997 Report.
29	- Collecting Income Tax Debts	Basia Ruta	
30	- GST: Audit and Special Investigations	Jim Ralston	
31	- Ensuring Fairness of the Income Tax System: Detection of Non-Filers and Special Investigations	Jim Ralston / Barry Elkin	
32	Department of Finance and Revenue Canada - Income Tax Incentives for Research and Development	Barry Elkin	
33	Department of Finance and Revenue Canada - Tax Assistance for Retirement Savings	Barry Elkin / Michael Adibe	Reported in Chapter 18 of the October 1997 Report.
34	Public Works and Government Services Canada - Management and Operation of Crown-owned Office Buildings	Michael Weir	Deferred. Government downsizing has resulted in departments being restructured and will result in a shift in focus for the follow-up. See Chapter 12 above. Tentatively planned to be combined with an audit of this area planned to report in 1999.
1995			
1	Ethics and Fraud Awareness in Government	Alan Gilmore	Reported in Chapter 1 of this Report. Other audits of this area are planned in the next three years.
4	Health Canada - Management of the Change Initiative at Health Protection Branch	Dan Rubenstein	Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.
5	Office of the Superintendent of Financial Institutions - Deposit-Taking Institutions Sector	Beant Barewal	Deferred. Tentatively planned to be combined with a follow-up of Chapter 30 of this Report. Planned to report in 1999.
6	Federal Transportation Subsidies - The <i>Western Grain Transportation Act</i> Program	Hugh McRoberts	Cancelled. These programs have been terminated by the government.

Year & #	Chapter Title	Responsible Auditor	Follow-up Status
	- The Atlantic Region Freight Assistance Program		
8	Travel under Foreign Service Directives	Trevor Shaw	Reported in Chapter 9 of the April 1997 Report.
9	Information for Parliament - Deficits and Debt: Understanding the Choices	Jeff Greenberg	Deferred. Tentatively planned to be combined with an audit of this area planned to report in 1998.
10	Crown Corporations - Fulfilling Responsibilities for Governance	Grant Wilson	Portions of the chapter are being followed up in a phased approach: S Performance measurement is followed up in Chapter 22 of this Report. S Further follow-up on special examinations is planned to report in 2000.
11	Environmental Management Systems: A Principle-based Approach	Wayne Cluskey	This chapter contained findings from a study conducted by the Office and contained no recommendations or observations that are subject to follow-up.
12	Systems under Development: Managing the Risks	Eric Anttila	Reported in Chapter 23 of this Report.
13	Canadian International Development Agency - Phased Follow-up of the Auditor General's 1993 Report - Phase I	Vinod Sahgal	This chapter was the first segment of a phased follow-up to Chapter 12 of our 1993 Report. Phase II was reported in Chapter 29 of our 1996 Report. Phase III is tentatively planned to report in 1998.
15	Public Works and Government Services Canada - Northumberland Strait Crossing Project	Tony Brigandi	Deferred. Tentatively planned to report in 1998.
16	Revenue Canada - Air Transportation Tax	Jim Ralston	Reported in Chapter 18 of the October 1997 Report.
17	Overview of Regional Economic Development Programs	Roger Simpson	This chapter contained an overview and common issues from Chapters 18, 19, 20 and 21. Follow-up of recommendations from each of these chapters is included in this Report.
24	Revolving Funds in the Parliamentary System - Financial Management, Accountability and Audit	Michael Weir	Deferred. Tentatively planned to report in 1998.
25	Revenue Canada - The New Regime for Processing Income Tax Returns	Basia Ruta	Reported in Chapter 18 of the October 1997 Report.

Emergency Preparedness in the Federal Government — Accidents Involving Oil and Chemicals — 1992, Chapter 24

Assistant Auditor General: David Rattray

Responsible Auditor: Alan Gilmore

Background

35.11 In 1992 we reported on emergency preparedness in the federal government. As part of that audit, we examined the government's ability to respond to three types of major disasters — earthquakes, nuclear emergencies and oil and chemical spills. In our November 1995 Report, we followed up on earthquake preparedness and, in particular, on the results of the 1994 CANATEX II exercise that dealt with response to a catastrophic earthquake in British Columbia. Among other things, we found that although valuable lessons were learned from it, the exercise did not provide a fully adequate basis for evaluating the effectiveness of the National Earthquake Support Plan.

35.12 This year we followed up on the section of the 1992 Report that dealt with accidents involving oil and chemicals. We examined the progress made in three important areas — marine oil spills, marine chemical emergencies, and non-marine chemical emergencies at industrial sites. We did not review preparedness for chemical emergencies that occur during transportation by land.

Conclusions

35.13 Since our 1992 audit, the government has established a private-sector-based marine oil spill response regime, which is expected to be certified and monitored by the Canadian Coast Guard and funded by ship and oil-handling facility operators. The Canadian Coast Guard has put extensive effort into establishing this regime; however, there is a major dispute over the fairness and equity of the proposed fees to fund the regime. These fees have not yet been approved by the Minister of Fisheries and Oceans. If the government is unable to resolve the dispute, the regime will not be financially viable. A consultant study on the subject is expected to report in the fall of 1997 on possible options.

35.14 Progress has been slow in establishing a system to respond to marine chemical emergencies. There are no national or regional plans to deal with marine chemical accidents. However, the Coast Guard is now in the preliminary stage of developing a chemical emergency response regime in conjunction with industry.

35.15 In our 1992 Report, we indicated that Canada did not have a national legislative framework for land-based chemical accidents. Such a framework is still not in place. However, since our 1992 audit, Environment Canada has drafted proposed amendments to the *Canadian Environmental Protection Act* (Bill C-74) that include a section dealing with environmental matters related to emergencies. Bill C-74 did not reach second reading in Parliament.

35.16 The Major Industrial Accidents Council of Canada (MIACC) has made progress but now needs to focus on increasing awareness and encouraging action, particularly on the risk assessment of hazardous installations.

35.17 To date, MIACC has identified a list of hazardous substances and developed an initial inventory of hazardous sites. It has identified about 1,350 hazardous sites containing substances that could, if improperly handled, lead to a major accident. These sites contain substances such as vinyl chloride, benzene, and gasoline. The inventory of hazardous sites has not yet been completed. MIACC is sending a survey to hazardous site operators for self-assessment of their safety management practices. The results of the survey are expected in the spring of 1998.

Observations

Marine oil spills

35.18 Major problems have been encountered in implementing the marine oil spill preparedness and response regime. Approximately 60 million tonnes of oil and petroleum products are loaded and unloaded annually in Canadian ports and within Canadian waters. In 1993, the last year for which spill data are available, there were 654 reported ship and shore-based marine oil pollution incidents, including intentional discharges. Following the occurrence of two high-profile oil spills in the late 1980s, the Nestucca and the Exxon Valdez, the government convened the Public Review Panel on Tanker Safety and Marine Spills Response Capability.

35.19 The September 1990 report of the Public Review Panel was highly critical of preparedness for oil spills. The shortfall in spill response capability was seen by the Coast Guard to be the most pressing priority among the report's many findings. The report stated:

- The capability to respond effectively to a marine spill of any significant magnitude does not presently exist anywhere in Canada.
- Each year, Canada can expect over 100 small spills (less than a tonne), about 10 moderate spills (about 100 tonnes), and at least one major spill (100 to 10,000 tonnes) from oil tankers. A catastrophic spill (greater than 10,000 tonnes), for which we are totally unprepared, can be expected once every 15 years.

35.20 The report recommended that within each region of Canada the "integrated industry-government spill response capacity must be sufficient to address marine spills up to 10,000 tonnes." The report recommended an investment of between \$150 million and \$200 million over five years in order to increase regional clean-up capacity to the minimum acceptable level.

35.21 In October 1991, the Treasury Board approved an increase of \$100 million over a six-year period for the Coast Guard, Environment Canada and Fisheries and Oceans to implement a strategy that responded to the key recommendations of the Panel. In 1993 an additional \$15.9 million was provided to the Coast Guard and \$1.2 million was provided to Environment Canada. In our 1992 Report, we noted that initiatives were only in the beginning stages or had not yet started.

35.22 Since 1992, the Coast Guard has done a significant amount of work to establish a marine oil spill preparedness and response regime. Amendments to the *Canada Shipping Act* enabling the implementation of the new regime were proclaimed on 15 August 1995. Among other things, amendments to the Act require that vessels and oil-handling facilities have emergency response plans. Vessels and designated oil-handling facilities are also required to have an arrangement with a response organization that has been certified by the Coast Guard to respond to a spill equal to the total amount of oil on board, up to a maximum of 10,000 tonnes.

35.23 The Coast Guard assessed two alternatives for funding the required upgrade of Canada's oil spill response capability:

- industry funding through a direct levy on oil imports and exports by ship; or
- a partnership approach involving joint government-industry arrangements for a response capability funded and operated by the private sector.

35.24 In 1993, after consultations with the oil and shipping industries, the second approach was chosen. It was decided that the Canadian Coast Guard would set standards, certify the response organizations and monitor spill

response. Five “response organizations” were created by the oil industry to provide a spill response capability south of 60° north latitude. The response organizations are required to submit response plans that demonstrate an ability to respond to an oil spill within a given geographic area of response. The Coast Guard assumes operational control of an oil spill response operation only if the polluter is “unidentified, unable or unwilling” to manage the operation, if the spill is north of 60° north latitude, or if the spill is a “mystery spill”.

35.25 A Panel was established to investigate the fairness of fees for assuring oil spill response capability.

The cost of establishing the response organizations was to be paid by fees collected from companies that could be involved in oil spills. The Coast Guard did not determine the fee to be charged; this was left to each response organization. The payment of the fee is for assurance of response capability in the event of a spill, not for actual response. If a ship or an oil-handling facility chooses to use the services of a response organization in the event of a spill, those services would be charged separately.

35.26 Before the fees can be approved by the Minister, they must be published in the *Canada Gazette*. On 16 September 1995, the fees proposed by the five Coast Guard-certified response organizations were published in the *Canada Gazette*. The proposed fee structure for four of the five response organizations consists of an initiation fee, a registration fee and a bulk oil cargo fee. One of the five response organizations excludes the initiation fee but charges a bunker fee. The proposed fees are:

- **Initiation fee.** This is a one-time payment of \$200 by both ships and designated oil-handling facilities. In the case of one of the response organizations, a bunker fee applies instead of the initiation fee. The bunker fee is to be paid by ships at a rate of \$100 for each transit through the response organization’s area of response.
- **Registration fee.** This is an annual fee of \$450 charged to both ships and designated oil-handling facilities.
- **Bulk oil cargo fee.** This is a levy based on the basis of the volume of oil handled multiplied by the bulk oil rate. The fee applies to designated oil-handling facilities for all oil that is unloaded or oil destined for foreign locations that is loaded at the facility. Where non-designated oil-handling facilities that do not have an arrangement with a response organization are involved, the fee is payable by the ship. The fee is a single rate expressed on a per tonne basis. It ranges across response organizations from 22.5 cents to \$1.85 per tonne.

35.27 Under Chapter 36 of the *Canada Shipping Act*, anyone who has reason to believe that the proposed fees are not fair and equitable can file a notice of objection with the Minister within 30 days of publication. Objections related to the fairness and equity of the proposed fees were received from 31 corporations, organizations and individuals within the 30 days. The objectors included vessel operators, independent oil-handling facility operators, and consignees, for example, airlines and power-generating facilities.

35.28 On 4 March 1996, the Minister of Fisheries and Oceans announced an investigation into the fairness and equity of the proposed fees and appointed a three-member Oil Spill Response Organization Fee Structure Investigation Panel. The Panel submitted its final report on 27 August 1996 to the Minister of Fisheries and Oceans.

35.29 The Panel criticized the overall approach to oil spills adopted by the Coast Guard. The Panel noted that the Coast Guard “continued to have prime responsibility for spill response, but had basically become a licensing authority for private sector response capability, but without any residual controls.” The Panel stated that the approach adopted “appeared to have been driven by the prevailing policies developed by the previous federal government intent on conveniently abrogating certain government responsibilities and simply maintaining a minimum of control.” It called for the Coast Guard to re-establish its principal role in the area of oil spill response and recommended that this be done by establishing a “National Spill Response Agency” that would be a “truly integrated public-private partnership between the Canadian Coast Guard, the oil and shipping industry and response organizations.”

35.30 Preparedness for oil spills has been enhanced but a complete assessment is needed. The Panel's report concluded that the response organizations are professionally managed and staffed and their equipment and resources are considered fully adequate to meet the standards set down by the Coast Guard. We note that since our 1992 audit:

- ships and designated oil-handling facilities are now required to have oil pollution emergency plans as well as an arrangement in place with a response organization certified to provide a response capability; and
- a national marine spill response exercise program has been developed.

35.31 Additional oil spill response equipment also has been acquired; however, the Coast Guard reports that the dollar value of response organization and Coast Guard stockpiles is below the investment recommended by the Public Review Panel on Tanker Safety and Marine Spills Response Capability.

35.32 The *Canada Shipping Act* now requires that the Minister review the "capability of response organizations to meet the arrangements required by ships and oil-handling facilities" and report to Parliament. The first Report to Parliament (1996) was mainly a description of the development of the new regime. The report indicates that the 1998 Report to Parliament will contain a more detailed account of the effectiveness of the regime. However, to make an assessment of the adequacy of the current Canadian oil spill response regime, the Coast Guard would have to carry out a review to verify the oil spill response capacity of the response organizations. Without such a review, the Coast Guard cannot conclude that the response capability for oil spills is satisfactory.

35.33 Exercises are one means of assessing the effectiveness of the response organizations. Under the *Canada Shipping Act* regulations, response organizations are required to evaluate the effectiveness of all aspects of the procedures, equipment and resources that are identified in the response plan through an exercise program. The program must be carried out at least once during a three-year period that begins on the day on which the certificate of designation is issued. The Coast Guard is responsible for monitoring the exercise program. Officials are concerned that they may not have the resources to fully monitor and assess response organization exercises.

35.34 The Panel concluded that the oil spill response fee structure is unworkable. The Fee Structure Investigation Panel criticized the Coast Guard for withdrawing from active control of the new regime by not setting the fee structure and concluded that the proposed oil spill response fee structure is unworkable since it is neither fair nor equitable. With respect to the major objections, the Panel concluded:

- The objectors' assertion that response organizations are unregulated monopolies is valid. This is compounded by the collusive relationship in the system, that is, oil companies are the major shippers of oil and owners of many of the oil-handling facilities and, at the same time, are the owners of the response organizations .
- Multiple fees are unfair and inequitable because a ship traversing several regions with the same risk could potentially be charged different fees.
- The "one fee fits all" fee structure is clearly inconsistent with the concept of a risk-based fee.
- Objections regarding unfair costing procedures are conjectural based on limited information obtained by objectors; however, concern about the high rate of return on investment and certain inconsistent practices in establishing the cost base is legitimate. The report concluded that the proposed fees are set to generate a level of revenue that will cover all costs plus a return on investment, and that the majority of the response organizations have built into the fee structure a rate of return on capital invested of almost 20 percent on a before-tax basis.
- The objection on the ground that the proposed fees would place a greater burden on some companies than on others is plausible.

35.35 Problems surrounding the new oil spill response regime fee structure remain unresolved. The Coast Guard engaged a consulting firm in the fall of 1996 to carry out a detailed analysis of response organizations' financial data in order to determine the fairness of the proposed fees as published in the *Canada Gazette*. This review is taking longer to complete than first anticipated; it is expected to be completed in the fall of 1997.

35.36 The Coast Guard is also awaiting the results of another consultant's report that is intended to develop options on:

- institutional arrangements for the Coast Guard within the existing policy framework;
- fee structure; and
- ensuring effectiveness of the response regime.

35.37 An options paper will be prepared for the Minister of Fisheries and Oceans and the Coast Guard. The Coast Guard anticipates that stakeholder consultation on these options will be completed by mid-autumn of 1997.

35.38 We recognize that extensive effort has gone into amending the *Canada Shipping Act* and establishing a marine oil spill response regime. However, given the Panel's conclusions that the current fee structure is unworkable, we are concerned about the viability of this regime. Since Canada's response capability is now to be based on private arrangements between ships and oil-handling facilities and response organizations for which a fee is paid, an inability to resolve the issues related to the proposed fee structures and broader policy issues means that the regime will not be financially viable.

Marine chemical emergencies

35.39 The Coast Guard believes the probability of a major marine chemical incident is relatively low but consequences may be significant. In 1994 the total domestic and international trade in hazardous materials — both in bulk and in containers — was approximately 15 million tonnes. A study commissioned by the Coast Guard stated that the development of a chemical emergency response regime must consider that although the probability of a major accident is low, the environmental consequences of a chemical spill may be significant. A chemical incident may be less likely to occur than an oil spill; however, because of the differences between oil and chemicals, the consequences may be far more severe. The Coast Guard lists some of the key differences that indicate why the consequences of a chemical incident can be more significant, depending on the substance(s) involved:

- There are a limited number of oil commodities, whereas more than 300 chemical products are shipped in bulk and thousands are shipped in containers.
- Oil products have similar physical properties, while there is a wide range of physical properties, such as flammability, toxicity and corrosiveness, among chemicals.
- In the case of oil, toxicity to humans is low. With chemical products there is a wide range of toxicity, with some being carcinogenic or immediately fatal.
- Oil has an immediate and visible impact on birds and marine life. Chemicals may have delayed and chronic effects.
- The impact of an oil spill is generally proportional to the size of the spill. The impact of a chemical spill is a function of the intrinsic properties of the chemical and is compounded by spill size.

- Oil does not react violently if mixed with water and/or other products. Chemical cargoes may react violently if mixed or upon contact with water or other materials.

35.40 The Coast Guard does not maintain a database on the frequency or nature of marine chemical incidents, but it believes that the incidence is relatively low. Some preliminary statistics, collected from various sources, were assembled as part of an internal study. The study identified a total of 87 reported incidents involving hazardous chemicals in a marine environment for the years 1991 to 1995 — an average of 17 identified incidents annually. None of these were major incidents.

35.41 The absence of good statistics on oil and chemical incidents is an area of concern and the Coast Guard indicates that it is in the process of pilot testing a Pollution Incident Reporting System to provide more comprehensive information on the nature and frequency of spills.

35.42 **There has been limited progress in developing a marine chemical response capability.** The report of the Public Review Panel on Tanker Safety and Marine Spills Response Capability concluded that Canada's ability to respond to marine spills of hazardous materials is, at best, limited. Although the Coast Guard has done some work in this area — for example, a review of practices of other countries, adoption of fundamental principles for design of the system and consultation with industry — progress in resolving this problem has been slow. At present, there is no national or regional integrated plan to deal with major marine chemical accidents.

35.43 The limited progress in this area is due, in part, to the difficulties in trying to first establish the marine oil spill preparedness and response regime. The oil spill regime was seen to be a priority because of the Public Review Panel's report and the two highly visible oil spills involving the Nestucca in 1988 and the Exxon Valdez in 1989.

35.44 The Coast Guard has indicated that it is now in the preliminary stage of developing a chemical emergency response regime in conjunction with industry. A fundamental requirement in developing this regime will be to clearly identify the roles, responsibilities and capabilities of government and industry.

Non-marine chemical emergencies

35.45 **Much remains to be done on the recommendations of the Bhopal Aftermath Review.** Following the 1984 Bhopal chemical accident, Environment Canada led a joint industry-government task force that examined the potential for Bhopal-type accidents in Canada. The resulting 1986 report, Bhopal Aftermath Review: An Assessment of the Canadian Situation, stated that the possibility of a major industrial accident does exist in Canada. The report suggested that the probability and impact of such an event could be significantly reduced if risks were properly identified and evaluated and contingency plans developed. The recommendations of the report related to both industry and all levels of government.

35.46 In 1996 Environment Canada assessed the progress by all levels of government and industry on the report's 21 recommendations, which were broken down into a total of 49 sub-recommendations for the analysis. The assessment rated the implementation of about half of the 49 sub-recommendations as "fair", meaning that most of the target audience is aware of what is needed but little or no action has taken place. "Good" ratings were given to 29 percent of the sub-recommendations, indicating that action steps have been implemented but that coverage is uneven, with critical gaps. A further 16 percent of the sub-recommendations were rated as "excellent", indicating full implementation. The report concludes that "good to excellent progress has been made on the development of products but the dissemination of these products to the industrial and municipal communities has only just begun."

35.47 **A legislative framework for chemical accidents at industrial sites is not in place.** In our 1992 Report, we indicated that Canada, unlike most modern industrialized countries, did not have a national legislative framework for chemical accidents at industrial sites that would provide for requirements on the reporting of chemicals used by industry, preparation of emergency plans, safety audits and reporting of spills. A legislative

framework is still not in place and we believe that this is needed to provide a sound regulatory basis to complement voluntary initiatives.

35.48 A 1994 Environment Canada issues paper, prepared for the review of the *Canadian Environmental Protection Act*, noted that the existing approach to environmental emergencies has tended to be reactive and has not focussed on public concerns about prevention and the right to know. With a shift in focus to the prevention of emergencies, it is important to first know the location of sites holding quantities of hazardous substances that pose a potential threat of off-site damage to the environment and the public. Once the sites are known, it would then be possible to assess the risks posed and raise awareness about these risks. Legislation would help implement these preventive measures; for example, it could provide the authority to have sites registered and to ensure that site operators assess the extent to which preventive and preparedness measures are in place.

35.49 Since our 1992 audit, Environment Canada drafted proposed amendments to the *Canadian Environmental Protection Act*, which the government introduced as Bill C-74 in December 1996. The Bill included a part of the Act dealing with environmental matters related to emergencies. This part of the Act would have given the Governor in Council, on the recommendation of the Minister, enabling authority to make regulations related to:

- establishment of a list of hazardous substances and minimum quantity related to each substance;
- identification of places where substances are located (in the prescribed quantities);
- the prevention of, preparedness for, response to and recovery from environmental emergencies;
- notification and reporting of environmental emergencies; and
- notification and reporting of preventive measures or measures to repair, reduce or mitigate any negative effects of environmental emergencies.

35.50 Bill C-74 did not reach second reading in Parliament. It is not known at this time whether the Bill will be reintroduced.

35.51 **MIACC has made progress but now needs to focus on risk assessment.** In our 1992 Report, we noted that one of the important recommendations of the Bhopal Aftermath Review that had been implemented was the establishment of the Major Industrial Accidents Council of Canada (MIACC). Environment Canada sees the partnership approach, promoted through MIACC, as the best means of preventing accidents and building preparedness in an area of fragmented jurisdiction. MIACC, which is viewed as an alternative to a strictly governmental regulatory approach, receives an annual contribution from the federal government, which will be about \$200,000 in 1997-98. It also receives funding from provinces, municipalities and industry. The mission of MIACC is to reduce the frequency and severity of major industrial accidents involving hazardous substances and to achieve harmonization in prevention, preparedness and response programs.

35.52 MIACC has made progress but now needs to focus on encouraging action, particularly on the risk assessment of hazardous installations. Until recently, MIACC has concentrated on developing new tools, such as training courses, guides and standards, for those working in the areas of prevention, preparedness and response. MIACC now sees itself shifting to a focus on "sensitization" — making target groups such as site operators and relevant community officials aware of risks and gaining their commitment to act to minimize risk. This change in focus is reflected by the work MIACC is currently doing with respect to hazardous installations and community preparedness. This work relates to observations made in our 1992 Report.

35.53 In 1986, the Bhopal Aftermath Review recommended that a site-specific risk assessment for each industrial plant be carried out to determine the potential for a major industrial accident. The 1990 Green Plan also

highlighted the need for an inventory of hazardous installations. In our 1992 Report, we indicated that Environment Canada did not have such an inventory and had not conducted reviews of accident prevention activities at potentially hazardous installations.

35.54 In 1995, the Report of the Standing Committee on Environment and Sustainable Development recommended that all sites be identified and registered, including sites owned by the federal government, where hazardous substances are found in quantities exceeding specified threshold amounts. The Committee suggested that the list of hazardous substances could be drawn up based on those already identified by MIACC and that the list could then be made available to local fire stations, those in charge of emergency preparedness and the general public if necessary.

35.55 **MIACC is developing an inventory of hazardous sites and encouraging site operators to undertake risk assessments.** Environment Canada informed us that it does not have the mandate to undertake assessments of hazardous sites, but it is working with MIACC in taking steps to address the issues of hazardous site identification and assessment.

35.56 The first step in assessing risks posed by hazardous sites is to identify the priority substances. MIACC has developed lists of hazardous substances and the threshold quantities above which the substances could present hazards to on-site workers, the general public, property and the environment if not handled properly. The presence of the substances on these lists at the threshold quantities does not necessarily mean there is an unacceptable level of risk. The risk becomes unacceptable when measures are not in place to manage the substances properly. The substances on "MIACC List 1" are those that could lead to major accidents if improperly handled, for example, vinyl chloride, benzene, and gasoline.

35.57 The second step is to establish an inventory of hazardous sites. MIACC is currently preparing an inventory of sites that have "MIACC List 1" substances in such quantity that they pose a risk of injury or death to people outside the site in the community. MIACC informed us that approximately 1,350 sites have been identified to date.

35.58 The third step is to assess the risk at each hazardous site. MIACC has begun the process of conducting a survey of process safety management. This is a self-assessment designed to determine the current level of awareness and use of major accident prevention and preparedness techniques at sites in Canada with potential for major hazards. Results of the survey are expected in the spring of 1998.

35.59 MIACC informed us that there are "MIACC List 1" hazardous sites located in approximately 450 communities. It is conducting a survey of the state of community emergency preparedness in these communities. This is being done, in most cases, through provincial agencies with emergency preparedness responsibilities.

35.60 MIACC's study of hazardous sites does not cover federal sites. Environment Canada indicated that it does not have responsibility for establishing an inventory of federal sites and that departments are responsible for their own sustainable development strategies and environmental management systems. However, Environment Canada has recently completed a study that identifies some federal sites where "MIACC List 1" substances are used or stored. The purpose of this study was to assess the actions that some federal departments have instituted in the areas of accident prevention, preparedness and emergency response. It should be noted that of the 20 sites studied, only one had stored a substance in a quantity exceeding the MIACC threshold limit. The study proposed a number of action items, including the development, in the federal government, of accurate inventories of federal facilities, the development of training programs regarding hazardous substances, increasing the awareness of MIACC tools and the development of a generic risk assessment document.

Correctional Service Canada — Custody of Inmates — 1994, Chapter 16

Assistant Auditor General: Maria Barrados
Responsible Auditor: Robert W. Chen

Background

35.61 In our 1994 audit of Correctional Service Canada, we reported on activities relating to the custody of inmates. We made a number of observations and recommendations concerning the design and application of the security classification system and the management of accommodation functions. Upon reviewing our audit, the Public Accounts Committee, in its Thirteenth Report released in June 1995, endorsed these recommendations. It also recommended that Correctional Service find savings in headquarters costs.

35.62 Our follow-up consisted of reviewing status reports prepared by Correctional Service on the progress it has made on our recommendations. We also reviewed the supporting documentation prepared by the Service and had discussions with its officials.

Conclusion

35.63 The Service has carried out a number of activities in response to the recommendations of our Office and the Public Accounts Committee in the area of security classification. However, continued management attention is needed if the Service is to further improve the objectivity of its security classification system. Such a system is critical for minimizing the risk to public safety and reducing prison operating costs. The Service needs to establish a process to monitor regularly the use of overrides of its Custody Rating Scale and to provide additional training to its staff on the use of the Scale when such needs are identified through monitoring. Sustained efforts are also needed to ensure that a more objective reclassification instrument will be fully implemented by 1999.

35.64 Correctional Service has acted on all our recommendations pertaining to accommodation planning, including using cost/benefit analysis in evaluating future accommodation projects, incorporating double-bunking and shared-accommodation strategies in its accommodation planning, and appointing a full-time senior executive responsible for all accommodation-related functions. We noted that the Service has clarified its definition of double-bunking to exclude custom-designed, shared accommodation and is planning to review its overall accommodation policy. These changes, in our opinion, need to be carefully addressed in its accommodation planning process.

Observations

Security classification

35.65 **Audit observations in 1994.** The practices of other jurisdictions and studies anchored by empirical data led us to conclude that an objective system is needed for both classifying inmates according to the risk they present and assigning them to the appropriate institution. Such a system uses statistically derived classification instruments to ensure that all known risks factors are considered and given proportional weight when determining a classification. In any well-designed security classification system, the results flowing from the instruments used can be overridden by staff where, in their opinion, an instrument fails to take into account such things as a medical

condition, a psychologist's report, rehabilitation program vacancies, or proximity to the inmate's home. To remain relevant and to ensure their continuing validity, classification instruments need to be revised periodically to reflect actual experience.

35.66 Overall, an objective system uses instruments that allow for consistency in decision making and for decisions to be more easily monitored. These benefits are difficult, if not impossible, to realize if the classification instrument relies only on subjective, qualitative information (commonly referred to as "gut feel") that allows individual staff members to introduce biases that may or may not be valid.

35.67 At the time of our 1994 audit, Correctional Service had a two-step classification process, not unlike many other jurisdictions. Inmates entering the federal correctional system upon sentencing were given an initial custody rating followed by a reassessment on an annual basis. As we noted in 1994, we were concerned that although Correctional Service has an initial classification instrument (the Custody Rating Scale) that is quantitative and objective, reclassifications (the Security Classification Review) are qualitative in nature and based almost totally on the individual judgment of case management officers. As a result, inmates with similar risk factors have been reclassified and placed in institutions with different and, possibly, inappropriate security levels.

35.68 From these observations, we, and later the Public Accounts Committee, recommended that Correctional Service improve its security classification system to make it more objective and allow for monitoring of results.

35.69 Follow-up audit observations. Our follow-up review confirmed that immediately following our audit, the Service required all case management staff to attend a three-day risk assessment course. This course emphasized the use of statistically derived instruments over that of subjective methods, as well the importance of always taking into consideration the risk to public safety when making case management decisions. The Service estimates that between 2,000 and 3,000 of its staff have completed the course. As well, the Service has continued to affirm these messages at training workshops and staff conferences and during routine queries and site visits.

35.70 By the end of 1994, Correctional Service began to apply the Custody Rating Scale to all offenders entering the system. However, the Service also required its staff to immediately apply its Security Classification Review guidelines, which had been used to change or override inmates' security classifications as determined by the Scale. In our opinion, this practice at offender intake assessment has been a significant factor in the large number of Scale overrides. In August, 1997, the Service issued a directive to stop this practice.

35.71 In 1996, Correctional Service completed a validation study of the Custody Rating Scale that confirmed that the Scale is well designed. This same study noted a 26 percent override rate and estimated that only about half of the overrides were for legitimate reasons. This level of overrides, in our opinion, indicates a continuing need for the Service to better train its staff on what constitutes a valid override.

35.72 The Service has not yet implemented a process to monitor regularly the extent of overrides. It is therefore unable to respond to the Public Accounts Committee's request that the Service assess, on an annual basis, the needs and level of understanding of its staff with regard to the Custody Rating Scale, and provide additional training as needed. The Service told us that beginning in December 1997, it will be able to report the number of and reasons for overrides.

35.73 Since the beginning of 1996, a considerable amount of work has gone into developing a new, more quantitative reclassification instrument used for security classification review. Correctional Service's Executive Committee is expected to approve the new instrument for field testing in November 1997. Following approval, additional field consultations, testing and validation will be required in addition to automating the instrument on its Offender Management System. The Service estimates that this instrument will be in place for use, at the earliest, by the end of 1998.

35.74 From the Offender Management System, Correctional Service now has better information to evaluate periodically the extent of overplacements or underplacements, that is, the number of inmates who are placed in institutions of a security level greater or lesser than the classification assigned to them. This information has been presented to and reviewed by the Service's Executive Committee and, subsequently, has been used by the Service to make periodic reviews of minimum security institutions to ensure that the risk from these institutions is minimized.

35.75 We noted that Correctional Service intends to use these security classification data for population forecasting and accommodation planning as recommended in our audit. This will begin January 1999 because four to five years of data are normally required to begin accurate forecasting.

Inmate accommodation

35.76 Audit observations in 1994. In 1994 we observed significant weaknesses in inmate accommodation planning. We noted that required life-cycle cost/benefit analyses were not performed and that Correctional Service had been slow to consider shared accommodation (cells designed and built to accommodate more than one person) as an option in accommodation planning.

35.77 Follow-up audit observations. Our follow-up review confirmed that all our recommendations in this area have been implemented. Correctional Service and the Treasury Board had agreed on a specific cost/benefit model in 1995, training for its use was provided to staff in both national and regional headquarters, and the model was used in the Service's 1996-97 and 1997-98 capital and accommodation planning. The position of Assistant Commissioner, Corporate Development was created and given responsibility for co-ordinating strategic and operational planning, of which accommodation planning is one aspect.

35.78 Correctional Service guidelines further indicate that double-bunking and shared-accommodation strategies have been incorporated as part of the planning process. Shared accommodation in housing other than cells has been developed and built by the Service. We noted that Correctional Service has clarified its definition of double bunking and is planning to review its inmate accommodation policy because, in its view, double occupancy is "an inappropriate permanent accommodation measure for good corrections."

Headquarters costs

35.79 Follow-up on PAC recommendation. The Public Accounts Committee recommended that Correctional Service find savings in headquarters costs. Based on our analysis of 1993-94 and 1994-95 cost figures provided by the Service, the average headquarters cost per inmate had decreased from the calculation included in our Report, which was based on 1992-93 data. This reduction was due largely to the downsizing efforts of Correctional Service at both its national headquarters and five regional headquarters, as well as to economies of scale obtained from a significant increase in the number of inmates.

National Parole Board — 1994, Chapter 17

Assistant Auditor General: Maria Barrados

Responsible Auditor: Robert W. Chen

Background

35.80 In our 1994 audit of the National Parole Board, we made a number of observations and recommendations regarding the appointment and development of Board members, the process used to make parole decisions and the completeness of information for decision making. Our follow-up in 1997 included a review of the status report prepared by the Board for the Public Accounts Committee on the progress made on our earlier recommendations. We also reviewed the supporting documentation provided to us by the Board and had discussions with its officials.

Conclusion

35.81 The Board has taken action and implemented all the recommendations in the areas within its control. It has made changes to the process for selecting Board members. Their selection is now open to all suitable candidates and is based upon the applicant's skills and abilities. As well, the Board has implemented a rigorous training program that is linked to a variety of performance feedback mechanisms that were not in place at the time of the 1994 audit. Our recommendations on ensuring that relevant offender information provided by Correctional Service Canada is available for decision making and on how it is provided will be followed up in our 1998 review of our 1996 Report chapter, Correctional Service Canada — Reintegration of Offenders.

Observations

35.82 **The Board has instituted a process for selecting members for referral to the Solicitor General that ensures that qualified people are appointed.** In 1994 we observed that there was public concern that the process for appointing Board members had resulted in the appointment of some who did not have the abilities and skills to do the job. We concluded that recent changes to the process to make it more open and merit-based should be continued and applied to part-time and full-time members.

35.83 For the purposes of our follow-up audit, we selected at random two appointments made in 1996 (one full-time member and one part-time member) to determine how the new process works. We observed that there is a standard process for choosing candidates with a background in criminal justice and an ability to apply risk assessment theory and knowledge to parole decisions. Our review confirmed that the process is applied to both full-time and part-time members and consists of the following elements:

- Board member vacancies are advertised in the *Canada Gazette*;
- applications are reviewed against detailed, specific criteria pertinent to carrying out the duties of a Board member;
- candidates are interviewed by a selection committee of senior Board officials who use a candidate-completed case study and interview guide to assess qualifications and suitability;

- a list of qualified candidates is submitted to the Solicitor General for consideration and recommendation to the Governor in Council; and
- appointments are made by Governor in Council from this list.

35.84 A comprehensive training regime for Board members has been instituted. In November 1995, the Board hired a firm to review the Board's training program. The review consisted of extensive on-site interviews and data analysis, including comparing a sample of parole decision sheets before and after risk assessment training. Following the review's completion, a Corporate Training Plan and National Training Framework were adopted by the Board.

35.85 As a result, current training for new members consists of:

- an introductory reading package pertaining to risk assessment and the correctional environment;
- an orientation pretest to determine the participants' threshold knowledge of risk assessment theory and application;
- a 15-day (formerly 10-day) orientation program consisting of classroom instruction, observation at parole hearings and visits to correctional facilities; and
- on-the-job training provided by the Regional Vice-Chair, senior regional staff and experienced Board members.

35.86 In addition, all Board members were required to attend a three-day risk assessment course, in 1993-94 and again in 1996-97, that covered the most up-to-date information on theory and application. Since 1995, the Chair has reinstated the three-day annual general Board meetings for all full-time members. They are provided with information and training on advances made in risk assessment research, on criminogenic behaviour and treatment of different types of offenders, and on lessons learned from previous Board decisions. As well, there are biannual regional training sessions lasting two to three days that target specific training needs identified in the annual performance appraisal process and by other means.

35.87 The Board has developed a variety of mechanisms to provide feedback to Board members, including information on successes and failures. Since our audit, the Board has developed a variety of mechanisms for assessing the performance of the Board as a whole. This includes a biannual Performance Monitoring Report that provides yearly data on decision trends, recidivism rates, success rates, rates of return and post-warrant expiry recidivism, by release type, offender risk profile and region. We acknowledge this performance assessment and reporting to be a major step forward from where the Board was in 1994. The Board recognizes, however, that while it is better able to collect and analyze information, it needs to continue to integrate this information into policy and practice.

35.88 Another major form of feedback the Board has implemented since our audit is a performance appraisal system to formally evaluate individual Board members' performance each year. For the purposes of this follow-up audit, we selected a total of five Board member performance appraisals (three full-time members and two part-time members). All of the appraisals followed the established framework and criteria developed by the Board in 1995 and incorporated a critical review of performance. They included examples of strengths and weaknesses as well as plans of action to remedy any weak areas of performance.

35.89 In 1995, the Board completed a comprehensive review of all reports concerning offenders on parole who committed further offences (usually violent) with an aim to identify areas that needed to be addressed through policy changes or training. In July 1996, a review of Board policy on inquiries and investigations was completed

and new procedures subsequently distributed. In addition, we found evidence that the Board uses the results of investigations as training aids and in the appraisals of individual Board members. In March 1997, for example, a training session on lessons learned was given at the annual general meeting. These were drawn from the experience gained internally through the Board's appeal division case reviews, audit and investigation case reviews, and legal challenges presented to the Board.

35.90 The Board has carried out several reviews of its operations to determine whether it is concentrating its time and effort in the most appropriate areas. In 1995, as part of the government's program and agency review exercise, the Board decided, consistent with the regulations, to reduce the number of members required to render decisions for cases in which there is less risk to public safety. For example, now only one member may be assigned to carry out a paper decision on accelerated parole review and only two members are required to render appeal division decisions. The Board is considering more changes.

35.91 Immediately following the 1994 audit, the Board, with members of Correctional Service Canada, formed a working group to determine the kind of information that the Board needs for decision making and the best format in which to present it to help members make appropriate decisions. This initiative has resulted in the development of the Risk Assessment Report that Correctional Service uses to recommend whether or not parole for an inmate is appropriate. We did not carry out further examination to determine the extent of this new report's implementation. In our November 1996 chapter, Correctional Service Canada — Reintegration of Offenders, we noted that there have been problems in implementing the report. In our follow-up, we plan to conduct a more complete examination of the progress in implementing the Risk Assessment Report and the recommendations pertaining to ensuring that all relevant information is available for decision making.

Environment Canada — Managing the Legacy of Hazardous Wastes — 1995, Chapter 2

Commissioner of the Environment and Sustainable Development: Brian Emmett
Responsible Auditor: Wayne Cluskey

Background

35.92 Our May 1995 audit examined certain aspects of federal management of non-radioactive hazardous wastes; specifically, Environment Canada's management of the remediation of contaminated sites and the storage and destruction of polychlorinated biphenyls (PCBs).

35.93 We focussed on Environment Canada's management of its responsibilities under the \$250 million joint federal-provincial National Contaminated Sites Remediation Program (NCSRP), which began in 1989-90. The objectives of the five-year program were to ensure the clean-up of high-risk orphan sites in Canada based on the "polluter pays" principle, to promote the development of the Canadian environmental technology industry and to clean up federal sites. We were concerned that when this program ended on 31 March 1995, adequate information on federal contaminated sites did not exist to properly inform Parliament of the health and environmental risks and clean-up costs.

35.94 We also examined the Department's administration of the PCB regulations on use, storage, export and treatment/destruction under the *Canadian Environmental Protection Act*. Under the Green Plan approved in 1990, the destruction of all federal PCBs was to be accomplished by 1996. However, the PCB Destruction Program ended on 31 March 1995 without this task having been completed.

Scope

35.95 Our follow-up involved reviewing two Environment Canada status reports on actions taken — one report prepared in June 1996 for the Public Accounts Committee and a second prepared in September 1996 at our request.

35.96 We conducted interviews and reviewed supporting documentation as well as other material prepared since the completion of the status reports to further assess the extent of the progress up to our cut-off date of 30 May 1997.

Conclusion

35.97 Although Environment Canada has taken action on many of our recommendations, we remain concerned about a number of recommendations that are taking longer to implement.

Observations

Parliament needs adequate information on the risks and clean-up costs of federal contaminated sites

35.98 We reported in the May 1995 chapter that the government did not have adequate information, including an inventory, on federal contaminated sites to determine and to report to Parliament on the health and environmental risks and clean-up costs.

35.99 Since the May 1995 chapter, two committees have been formed — the Contaminated Sites Management Working Group (CSMWG) and the Environmental Accountability Partnership Policy Sub-committee (EAP Sub-committee) — to develop a common federal approach to dealing with federal contaminated sites.

35.100 The CSMWG committed itself to a workplan, including the task of Site Assessment and Associated Liability. As part of that task, the Working Group developed a definition for contaminated sites and a template to record summary inventory data. In addition, the CSMWG is supporting the Federal Committee on Environmental Management Systems in its efforts to assist with the development of environmental management systems and sustainable development strategies, both of which should contain components addressing contaminated sites. The EAP Sub-committee has developed a draft general policy on contaminated sites, which is currently under discussion; however, it has not established any departmental deadlines, including one for the implementation of the inventory template.

35.101 In Chapter 22 of our November 1996 Report, we looked at departments' progress in identifying, assessing and remediating federal contaminated sites. We concluded that accurate and complete summary data of departmental inventories and estimated costs, both by departments and centrally, will likely not be available for some time. This information is needed to ensure that the high-risk sites posing the greatest risk to public health, safety and the environment are among the first to be remediated.

Action plan needed for federal contaminated sites

35.102 The government continues to disagree with us over the need for an action plan to complete the assessment and remediation of all federal contaminated sites; it emphasizes that federal departments are responsible for cleaning up their own sites. The government states that progress on federal contaminated sites will be accomplished through existing government policies and the CSMWG and the EAP Steering Committee (parent of the EAP Sub-committee). We continue to believe that a federal government action plan is required to ensure that the job gets done within reasonable time frames and to a consistent standard of remediation.

Disclosure of potential federal environmental liabilities in the financial statements

35.103 Environmental liabilities of the government are likely quite significant and could materially affect the government's reported financial condition. We recommended in our May 1995 Report (Chapter 2) that potential federal liabilities related to the clean-up of contaminated sites that can be determined and reasonably estimated be disclosed in the audited Financial Statements and Annual Financial Report of the Government of Canada. In the last three fiscal years, potential environmental liabilities of \$2.8 billion (an incomplete figure) have been disclosed in the Notes to the Financial Statements and the Annual Financial Report. In the Observations on the Summary Financial Statements, the Auditor General has encouraged the government to quantify at the earliest possible date the full extent of the environmental liabilities, to develop appropriate methodology to distinguish between environmental liabilities and contingencies, and, in the interim, to improve disclosure.

35.104 There has been limited progress on the Auditor General's recommendations in the Observations on the Summary Financial Statements. In Chapter 22 of our November 1996 Report, the Treasury Board Secretariat stated

that it “does not expect to issue and implement a policy before the 1998-99 fiscal year.” We understand that the Secretariat is in the process of developing an environmental accounting policy. The draft policy is to be distributed to stakeholders for review and comment in 1997-98 and is to build upon the recommendations of the CSMWG for the consistent recording of information in the inventory of contaminated sites. The inventory is to be based upon the National Classification System for Contaminated Sites issued under the aegis of the Canadian Council of Ministers of the Environment. The assessment process for placing a site in the inventory includes the requirement to estimate the costs of remediation. The Treasury Board Secretariat states that when the assessment process is substantially complete, this inventory will facilitate the quantification of the government’s liability for incorporation in the summary financial statements.

35.105 While we have no reason to doubt that the Treasury Board Secretariat will implement a policy by 1998-99, we remain concerned about departmental readiness, given the lack of progress to date.

***Treasury Board Secretariat’s response:** In developing an appropriate accounting policy, the Secretariat is working through an interdepartmental committee that, in turn, is developing a policy for the management of contaminated sites. Through this process, the Secretariat is confident that all departments responsible for contaminated sites will be ready to implement the accounting policy by 31 March 1999.*

Destruction of federal PCBs

35.106 Under the Green Plan approved in 1990, the destruction of all federal PCBs was to be accomplished by 1996. However, we reported in May 1995 that achievement of this goal had been impeded due to:

- the failure of Environment Canada to report to Parliament on progress made to date on PCB destruction and to provide a realistic assessment of risks and costs needed to destroy the total federal inventory; and
- the termination of Environment Canada’s leadership role in the management of PCB destruction with the end of the PCB Destruction Program at 31 March 1995.

35.107 Since the sunset of Environment Canada’s PCB Destruction Program, Public Works and Government Services Canada (PWGSC), with support from Environment Canada, assumed responsibility as the federal government’s service agent for the collection, transportation and destruction of all federally stored PCBs, as well as the closure of their storage sites. Many departments and agencies have taken advantage of the PWGSC services.

35.108 As of January 1997, PWGSC reported that less than two percent of federal PCB waste remained in storage from Environment Canada’s original 1995 waste estimate of 5,600 tonnes. Since the May 1995 Report, the number of PCB storage sites has been reduced from 495 (1993) to 227 (April 1997). However, the amount of federal PCB waste in storage and the number of storage sites are dynamic. The numbers will change as PCBs come out of service and as PCBs in storage are destroyed. Storage sites are beginning to fill up again with PCBs coming out of service. As well, PWGSC’s destruction program has recently been stalled due to difficulties at the Alberta Special Waste Treatment Centre (Swan Hills).

35.109 PWGSC would like to continue to offer PCB destruction services to federal departments and agencies because of the continuing need and to seek cost efficiencies. As of May 1997, PWGSC senior management was being briefed on the PCB destruction program and options for continuing this service.

35.110 Environment Canada has committed itself to providing a report to Parliament in 1997 that will address the progress made to date on PCB destruction and the risks and costs associated with the remaining federal PCBs. At 30 May 1997, the report had not been drafted, nor was there a target date for its completion.

Federal Radioactive Waste Management — 1995, Chapter 3

Assistant Auditor General: Maria Barrados

Responsible Auditor: Ellen Shillabeer

Background

35.111 Our May 1995 audit assessed whether the federal duties related to responsible management of radioactive waste were clearly defined and assigned. It also covered the related federal government initiatives undertaken and the costs incurred to date, and assessed Canada's progress in those initiatives.

35.112 Since we issued our Report, developments have occurred that move Canada closer to finding long-term solutions for its radioactive waste.

35.113 Natural Resources Canada (NRCan) has developed a policy framework for radioactive waste and has consulted with stakeholders on institutional and financial arrangements for radioactive waste disposal. It has also signed a memorandum of agreement with Ontario to assign responsibilities for decommissioning and long-term management of any "abandoned" uranium mine sites and uranium tailings. The Canadian Environmental Assessment Agency (CEAA) Panel on the Nuclear Fuel Waste Management and Disposal Concept completed its hearings and is developing its recommendations. NRCan has been negotiating for a site for historic low-level radioactive waste and has extended the mandate of the Low-Level Radioactive Waste Management Office.

35.114 This year we followed up on each of the recommendations in our May 1995 Report chapter. We reviewed NRCan's July 1996 status report to the Public Accounts Committee on action taken in response to our recommendations. Departmental officials provided us with an update on this status report. We discussed ongoing progress, obtained and reviewed supporting documentation and incorporated relevant information into this follow-up report up to 1 September 1997.

Conclusion

35.115 NRCan has taken steps in the right direction to address our audit concerns and to find long-term solutions for Canada's radioactive waste. However, much remains to be done. We recognize that the resolution of some of our concerns requires the involvement and actions of other parties. The Department has been constrained by the CEAA Panel's timetable, the uncertainties of the negotiation process for a site for historic low-level radioactive waste and the large number and various types of stakeholders to be consulted. We will continue to follow up on NRCan's actions and report on them at a future date.

Observations

A policy framework has been developed for radioactive waste

35.116 In July 1996, the Minister of Natural Resources announced the government's approval of a Policy Framework for Radioactive Waste to guide Canada's approach to disposal of high-level (nuclear fuel waste) and low-level radioactive wastes and uranium mine and mill tailings into the next century. The Policy Framework lays out the ground rules for radioactive waste disposal in Canada. It defines the role of government and waste producers

and owners, and recommends that disposal proceed in a comprehensive and integrated manner. The Policy Framework also sets the context for further development of the financial and institutional arrangements.

35.117 In October 1996, NRCan issued a discussion paper to seek stakeholder views on the federal oversight role, on how the stakeholders would organize for waste disposal and on how they propose to fund disposal programs. At the time of our follow-up, the Department had received feedback, but indicated that it will wait for the CEEA Panel's recommendations before continuing work on the institutional and financial arrangements.

Decision on a long-term solution for nuclear fuel waste awaiting results of the CEEA Panel

35.118 No decision has been made on how to proceed with a long-term solution for managing nuclear fuel waste. In March 1996, the CEEA Panel on the Nuclear Fuel Waste Management and Disposal Concept began a three-phase public hearing process on the Atomic Energy of Canada Limited's concept of deep geologic disposal of nuclear fuel waste. The Panel finished its hearings in March 1997 and is expected to submit its recommendations on the safety and acceptability of the disposal concept to the Minister of Natural Resources and the Minister of the Environment in early 1998. Any response by the government will be made only after consideration of both the Panel's recommendations and stakeholders' views from the Policy Framework consultations.

Negotiations continue on a disposal facility for historic low-level radioactive waste

35.119 The federal government set up a task force to make recommendations on the long-term management options and to identify possible disposal sites for historic low-level radioactive wastes. In July 1995, the Siting Task Force and the Town of Deep River signed a Community Agreement-in-Principle (CAP) that set out the terms and conditions for a proposed facility for the disposal of low-level radioactive waste in Deep River. A condition in the CAP was that the agreement had to be converted into a contract before 31 December 1996. Following community endorsement of the CAP in September 1995, the federal government announced its intention in July 1996 to proceed with negotiations with the Town. However, during negotiations it did not accept some of the conditions in the CAP; thus a contract between the two parties was not reached by 31 December 1996. In early 1997, the Minister of Natural Resources and the Mayor of the Town exchanged letters in an attempt to continue discussions. Negotiations based on a new set of conditions got under way in July 1997. If a legal agreement is struck, the appropriate review and licensing will be required.

Mandate of Low-Level Radioactive Waste Management Office has been extended

35.120 In March 1995, the federal government extended by five years the mandate of the Low-Level Radioactive Waste Management Office, the federal agent designated for cleaning up historic low-level radioactive waste. This action provides the required continuity in federal responsibilities for the management of Canada's historic low-level radioactive waste and addresses our recommendation.

AECB has initiated action to license the pre-1976 uranium mines and tailings sites

35.121 The Atomic Energy Control Board has corresponded with current owners of the 11 pre-1976 tailings sites to invite them to complete and submit an Application for Prescribed Substance Licence. One site is now under AECB licence, and negotiations are taking place with the owners of the other sites concerning possible licensing of their sites. AECB expects to have most pre-1976 tailings sites licensed by 1998.

35.122 AECB believes that none of the pre-1976 tailings sites represents an immediate threat to health, safety or the environment but that appropriate steps must be taken to ensure their long-term acceptability.

Decommissioning and long-term management responsibilities of any “abandoned” uranium mine sites and uranium tailings are resolved for Ontario

35.123 In January 1996, the Minister of Natural Resources signed a Memorandum of Agreement with the Ontario Minister of Northern Development and Mines on the cost sharing of any decommissioning activities and on the long-term management responsibilities needed for any “abandoned” uranium mine sites and uranium mine tailings in the province. Although this agreement applies only to sites in Ontario, it represents most of the estimated decommissioning costs for all uranium mine sites and uranium tailings in Canada that are or could potentially be abandoned.

35.124 NRCan officials have discussed with Saskatchewan officials the possibility of a similar initiative for their province.

NRCan and AECB have a common understanding about the underlying assumptions of volumes and cost data

35.125 NRCan and the AECB have reached a common understanding about the underlying assumptions that resulted in differences in estimates of volumes and costs for the decommissioning of uranium tailings. The data were reconciled during the joint effort of NRCan, AECB and Ontario in developing the Memorandum of Agreement discussed in paragraph 35.123.

Disclosure of potential federal environmental liabilities in the Notes to the Financial Statements includes liabilities for radioactive waste

35.126 Our May 1995 chapter estimated that the potential federal liabilities related to finding solutions for radioactive waste totalled approximately \$850 million. We recommended that those potential federal liabilities related to radioactive waste that can be determined and reasonably estimated be disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report of the Government of Canada. In the last three fiscal years, the potential federal environmental liabilities for both radioactive and non-radioactive waste, although an incomplete estimate, have been disclosed in the Notes to the Financial Statements and in the Notes to the Annual Financial Report. For further details, refer to paragraphs 35.103 to 35.105 in this chapter.

Industry Canada — Business Assistance Programs in Transition — 1995, Chapter 14

Assistant Auditor General: Richard Flageole

Responsible Auditor: Peter Simeoni

Background

35.127 Our 1995 audit focussed on business assistance programs. We selected for audit four financial assistance programs, support to tourism and the Canada Business Service Centres initiative.

35.128 During our audit, the government announced that it was terminating a number of programs including almost all those that we had selected, such as the Sector Campaigns and the tourism sub-agreements. Tourism Canada was wound up but was replaced by the Canadian Tourism Commission in January 1995. Only the Business Service Centres remain today.

35.129 We recognize that Industry Canada's programs have been modified considerably and that, moreover, there is a considerable reduction in the grants and contributions budget of the Department. However, we believe that the recommendations formulated in our 1995 chapter are still relevant. On the one hand, Industry Canada must continue to pay attention to its old programs. Even though they have been terminated or wound up, they are still making payments to businesses that will be repayable to the government over a number of years. On the other hand, the good management principles we recommended also apply to the new contribution programs managed by the Department.

35.130 Our follow-up consisted of a review of the Department's reports on its progress in response to our 1995 recommendations. We also examined supporting documentation and held discussions with the responsible managers.

Conclusion

35.131 The Department has generally taken satisfactory steps to respond to our 1995 recommendations. However, we cannot yet fully assess the initiatives taken to improve project evaluation procedures, since these are part of a new program, Technology Partnerships Canada, which we have not audited. We will take this fact into account when developing plans for future audits.

Observations

Financial contributions programs

35.132 Repayment for terminated programs. During our 1995 audit, we asked who was responsible for the repayment of contributions under terminated programs now that the project officers who had been dealing with businesses in the regions no longer handled projects. As there was no one responsible, we recommended that the Department clearly assign responsibility for monitoring and verifying repayment of contributions.

35.133 Following the 1995 Budget, Industry Canada decided to centralize program delivery in Ottawa. A program and repayment section was established in the fall of 1995 to handle repayments for almost all terminated programs.

35.134 Departmental representatives indicated to us that the policy and operational improvements made during 1996-97 were instrumental in convincing businesses that the Department is serious in its efforts to ensure repayments of contributions. For example, businesses that are awarded new contributions under other departmental programs must first repay any amounts they owe before receiving additional payments. The representatives also informed us that additional improvements are being made. They recently put into place a program to audit the sales reports of businesses, to ensure the accuracy of the sales figures on which the royalties owing are calculated. According to the Department, \$69 million was recovered in 1996-97, which represents twice the historic average of past years. The Department hopes to collect \$74 million in 1997-98.

Assessment of applications

35.135 Since the programs audited in 1995 no longer existed at the time of our follow-up, we decided to turn our attention to the Technology Partnerships Canada (TPC) Program. We looked at the process established under the new program for assessing funding applications.

35.136 Technology Partnerships Canada is a special operating agency that was established in March 1996. Its budget is \$200 million for 1997-98. By making contributions available to the private sector, Industry Canada shows that it wants to share the risks with private industry, but also to profit from its investments.

35.137 Unlike previous programs, all project decisions are reviewed by the Program Services Directorate. This section is separate from the decision-making process and reports to the Executive Director. We believe that the establishment of a separate unit to handle quality control within TPC should help respond to the observations in our 1995 Report. However, the limited work carried out as part of the follow-up does not permit us to make more detailed comments on this subject.

Direction of government assistance programs

35.138 In 1995, we recommended that Industry Canada ensure that its application of the policy on repayable contributions is consistent with the intent of the policy to orient government assistance programs more toward investment than subsidization. The vast majority of the contributions paid out under programs that we audited were not repayable.

35.139 In February 1996, the Program and Service Board approved changes to the departmental policy, limiting situations where contributions are no longer repayable. These changes included the elimination of the \$100,000 threshold, below which contributions were rarely repayable. The policy also states that possible exemptions are no longer generally applicable but are instead to be used only when fully justified. We are satisfied with the actions taken by the Department to amend its policy.

Canada Business Service Centres

35.140 The Canada Business Service Centres (CBSCs) network comprises 12 centres, one in each province and territory. The primary role of the centres is to provide, under a single roof, all available information required to respond to the needs of businesses. There is a National Secretariat whose main function is to provide centralized support to the network of regional centres and to facilitate the development of the CBSC initiative. Among other things, it is responsible for providing and updating federal information for the network.

35.141 In 1995, we recommended the development of a common vision, national guiding principles, and a limited number of basic service standards. In February 1996, the CBSC Committee of Managing Partners approved a vision statement for the CBSC initiative. That document set out the mission, guiding principles and service standards for the CBSC network. The next phase involved applying the standards throughout the network.

35.142 We believe that there is still work to be done on the publication of standards. Only two CBSCs had published their service standards on the Internet at the time of our follow-up. Departmental representatives informed us that a CBSC Internet Working Group is currently developing national service standards to be added to the CBSC main Web site.

35.143 We noted in 1995 that the information given on certain programs was out-of-date or inadequate in some cases. We recommended that the Secretariat help the CBSCs to resolve these problems. As a result, standards for the quality and timeliness of federal information have been used by the National Secretariat since April 1996. They involve monthly updating of the most frequently used 20 percent of federal information and updating the remaining information within a period of not more than six months. There is a system to track the number of times users access information about each program on the Internet. The National Secretariat is planning to extend the compilation of data by incorporating inquiries from sources other than the Internet. According to departmental representatives, the Secretariat maintains frequent contact with its partners and monitors all government announcements to identify new programs.

Travel and Hospitality — 1995, Chapter 7

Assistant Auditor General: Doug Timmins

Responsible Auditor: Hugh McRoberts

Background

35.144 Our 1995 chapter focussed on the management of public service travel spending by departments and agencies. We recommended that the Treasury Board Secretariat:

- consider providing public information on travel;
- pursue the implementation of automated travel systems and help specify the information needed to manage travel better;
- assess and further clarify the application of policy for business-class travel and travel bonus points;
- consider publishing principles of behaviour in government travel; and
- assess possible changes to the Travel Directive and Travel Guide.

35.145 In addition, we recommended that Public Works and Government Services Canada (PWGSC) develop better ways of measuring the use of travel and progress toward a goal of least-cost travel.

Scope

35.146 Our follow-up was limited to reviewing status reports prepared by both the Treasury Board Secretariat and PWGSC in August 1997 on the actions taken to address the 1995 recommendations. We also reviewed supporting documentation and conducted interviews to discuss and assess actions taken.

Conclusion

35.147 Both the Secretariat and PWGSC have initiated action to address the recommendations that we raised in 1995. Work remains to be done in some areas.

35.148 Work is continuing on the development of an improved Travel Expert System that can be used by managers and travellers to reduce the cost of travel administration and provide better information for improved accountability.

35.149 The Secretariat cannot unilaterally change the Travel Directive, and discussions are ongoing with employee unions to address the terms and conditions of the Directive. Reduction of administrative costs and improved technology and systems are the goals of the Secretariat throughout these negotiations. The impact of initiatives that may result from these negotiations is not known at this time.

35.150 The current travel service contract expires 31 December 1997. PWGSC has indicated that the new contract will focus on service to clients and reducing costs through the use of technology. As the final contract had not been awarded at the time of our follow-up, we are not yet able to assess the impact of this initiative.

Observations

Public information on travel

35.151 The Treasury Board Secretariat still does not believe there is a need to develop a government-wide report on travel. According to the Secretariat, the information is not available and departmental coding is not set up to accommodate this request.

Automated travel systems

35.152 Work is in progress to update the current DOS-based Travel Expert System to a Windows and Internet environment. This would reduce the technical support requirements of the users, reduce costs, provide better travel information and be an important step to achieve client acceptance of this system. Also, a new automated management reporting system, "Reportlink", has been installed in over 240 locations across government. It is a PC-based relational database system that has replaced the use of extensive hard-copy standard reports.

Business-class travel and travel bonus points

35.153 The Treasury Board Secretariat has reviewed the business-class travel policy and believes that it is carefully defined in the Travel Directive and applies to the majority of public servants. The Secretariat is reviewing the current policy on travel bonus points, in conjunction with the new Request for Proposal described below.

Publishing principles of behaviour for government travel

35.154 The Secretariat believes that books on ethics, values and behaviour, if developed, should not be directed at one isolated aspect of government expenditure (travel) but at conduct in general expected of public servants.

Changes to the Travel Directive and Travel Guide

35.155 It is the intent of the Treasury Board Secretariat to revise the Travel Directive, with the goal of reducing the administrative costs of travel, and to recognize the importance of improving technology and systems. The Travel Directive is a National Joint Council agreement that forms part of employees' collective agreements.

35.156 Proposals for changes to the Directive require agreement by public service unions, and discussions on those proposals have commenced. The Travel Guide is a tool used to explain the Directive and it should reflect, in a timely manner, changes made to the Directive.

Measuring the use of travel toward a goal of least-cost travel

35.157 PWGSC has taken the following measures to address our recommendation:

- A new automated travel management reporting system, "Reportlink", was implemented across 68 government entities and provides standard, as well as customized, travel reports to meet clients' specific needs.

- Random reviews of airfares were introduced.
- A new Low Fare Guarantee process was negotiated with the current Government Travel Service contractor in April 1996.
- As the current contract expires in December 1997, PWGSC issued a Request for Proposal (RFP) for a new travel service contractor in July 1997. The RFP aims at maximizing service to travellers, reducing costs through the use of technology (for example, automated booking) and providing a distinct international service. The RFP is based on a fee-for-service regime, which will enable the government to negotiate preferred airfares with air carriers.

Atlantic Canada Opportunities Agency — 1995, Chapter 18

Assistant Auditor General: Don Young

Responsible Auditor: John O'Brien

Background

35.158 In 1995, we recommended that the Agency improve the measurement and reporting of the results achieved by its programs, including improving the clarity and measurability of objectives for key programs and the techniques used in program evaluations. We noted problems with the input and assumptions used in the econometric modelling exercise used to evaluate the Action Program. In addition, we recommended that the Agency ensure that its results measurement distinguish clearly between actual and projected results. We suggested that for COOPERATION agreements, information on recipients, activities and results should be maintained in a consistent form that is readily accessible.

35.159 We recommended that, during the project approval process, the Agency ensure that expected project results are specified and clearly linked to the objectives of the programs. The risks of projects not achieving their goals needed to be considered in the type of assessment procedures employed. We also had concerns about the adequacy of monitoring of project progress and results.

35.160 Since the 1995 audit, the Agency has replaced one of its major programs, the Action Program, with the Business Development Program. In addition, the Agency has implemented the government's policies covering the repayability of support to business.

Scope

35.161 Our 1997 follow-up work involved reviewing the Agency's status report on progress in implementing the recommendations. Our conclusions are based on interviews with Agency officials and a review of documents provided to us by the Agency, including the changes to its policies and procedures for project management and decision making.

Conclusion

Measuring and reporting results

35.162 Since 1995, the Agency has undertaken various performance measurement initiatives. We noted that in its 1996 Performance Report to Parliament and the 1997-98 Main Estimates, the Agency identified six strategic priorities, with performance indicators that were stated in clear and measurable terms. Subsequent results measurement will be against these performance indicators. According to the Agency, program initiatives or projects must, as a minimum, meet one of the strategic priorities or the overall Agency mandate of increased employment and earned income.

35.163 The Agency has made progress in improving some of its results measurement and reporting processes. The 1996 Performance Report to Parliament clearly indicates what results are being reported and the means by which those results are being reported. However, we did not audit the information presented to us by the Agency; therefore, we were unable to determine whether the Agency has made improvements in the measurement of the

numbers of jobs created and maintained. The processes used for measuring results of the COOPERATION Program remain largely unchanged from 1995. Further, the program objectives for both the Business Development and COOPERATION programs remain broad, making subsequent program evaluation difficult.

Project management and decision making

35.164 The Agency has made progress in improving its project management and decision making for the Business Development Program. It is in the process of changing its monitoring procedures. In the one region that is taking the lead on this initiative, we noted that the monitoring of projects was based on the risks associated with the effective implementation and attainment of the project objectives. This is consistent with the intent of our recommendations. In this initiative, account managers are expected to have an understanding of client operations and the progress and results of projects. There has been less progress in changes to project management and decision making for the COOPERATION Program.

Observations

Measuring and reporting results

35.165 Since completing the program evaluations of the Action and COOPERATION programs, the Agency has moved toward developing ongoing performance measures. It has changed its approach to performance measurement by measuring results against six strategic priorities rather than against individual program objectives. For the most part, the performance indicators developed for these strategic priorities are stated in clear and measurable terms.

35.166 Our review of the studies that support the performance measures reported in the Agency's 1996 Performance Report to Parliament and the 1997-98 Main Estimates found that the Agency has attempted to address the concerns raised in our 1995 audit. Without conducting an audit of the information presented to us by the Agency, we were unable to determine whether the Agency has made improvements in the measurement of the numbers of jobs created and maintained. In its econometric modelling exercise, which converts the number of jobs created and maintained into the total economic impact on the Atlantic economy, the Agency continues to use the assumption that all of the jobs created by the program will last for a period of 10 years. As in 1995, we were not able to find support for this assumption.

35.167 The Agency has recognized some of the inherent difficulties associated with the use of a client survey as the primary source of results information. To address this matter, the Agency is in the process of establishing a benefit monitoring program. This program is designed to ensure that Agency staff actively monitor key expected results, such as jobs created and maintained, for a sample of Agency projects and thereby provide an estimate of the results achieved for all of the Agency's program activity. These results will be corroborated through ongoing client surveys. We believe that these planned changes could greatly benefit the results measurement processes of the Agency if they are implemented appropriately.

35.168 The evolution of the Agency's performance measurement practices has occurred at a time when several important program changes, such as repayability of assistance to business, have been implemented. There has been an apparent lack of emphasis on program evaluation in favour of performance measurement. Although the latter is a very useful tool, it is not a substitute for program evaluations that provide assessments of the rationale for programs, the impacts and effects that can be attributed to them (including their success in achieving program objectives) and the cost-effectiveness of alternative means for achieving objectives. In this context, we note that the objectives for both the new Business Development and the COOPERATION programs remain very broad, which will make it difficult for future program evaluations to assess the extent to which objectives have been met.

Project management and decision making

35.169 The Agency has put considerable effort into changes in its assessment processes for the Business Development Program. The 1995 audit found that projects were screened based only on the size of a project. The assessment procedures now call for risk analysis based on the key economic development factors (such as viability, incrementality and net economic benefit), as well as on project size.

35.170 The Agency has indicated that two of its regions are employing new means of monitoring Business Development Program projects. For the one process that we reviewed, the monitoring of projects was based on the risks associated with effective implementation (for example, financial and human resources available to support the project) and the attainment of the project objectives. Account managers are expected to have an understanding of client operations and the progress and results of projects based on the risks associated with the project.

35.171 The COOPERATION Program now funds only non-commercial projects. Thus, the Agency considers the individual eligibility criteria for COOPERATION agreements to be more relevant than the key economic development factors mentioned earlier. While the Agency has moved to streamline the number of COOPERATION agreements with individual provinces, agreement objectives are still not stated in a clear, measurable and results-oriented manner. The Agency has indicated that it will monitor COOPERATION projects through the benefit monitoring program in the future. Results measurement will be through program evaluation of individual agreements and surveys. With the exception of the planned implementation of the benefit monitoring program, the assessment and monitoring processes used by the Agency are not significantly different from those found in the 1995 audit. The Agency had developed the means to acquire information on recipients and activities for COOPERATION agreements. Recently, it has had to revise its approach to information gathering because of systems changes on the part of several of its provincial partners.

Federal Office of Regional Development? Quebec — 1995, Chapter 19

Deputy Auditor General: Michael J. McLaughlin
Responsible Auditor: Micheline Ethier Massicotte

Background

35.172 At the time of our audit in 1995, the Federal Office of Regional Development-Quebec (FORD-Q) had begun implementing its new program, which consisted primarily of the IDEA-SME program. This program differed significantly from the previous program, which had focussed on financial assistance for capital projects. IDEA-SME provides small and medium-sized businesses in Quebec with an integrated package of financial and non-financial services, such as the distribution of strategic information and advisory services. Financial support is now considered an extension of non-financial services and focusses more on the funding of activities such as market studies and participation in seminars or trade missions.

35.173 Our 1995 chapter highlighted a number of major challenges that FORD-Q would have to meet in order to successfully implement its new program and achieve the expected results. We also made a number of observations and formulated recommendations on the delivery of financial assistance programs, ongoing performance measurement and program evaluation.

35.174 Our follow-up work consisted primarily of discussions with representatives from the Department regarding measures taken in response to our recommendations, and a review of the supporting documents. We did not attempt to evaluate the measures taken.

Conclusion

35.175 FORD-Q has acted on all our recommendations. It has begun to meet all the challenges relating to the implementation of its new program, but progress regarding the delivery of financial services has been slower. Nevertheless, it has achieved considerable progress in the area of results-oriented management.

35.176 However, there is still much to do. A large number of measures have been implemented recently or will be over the course of the next year. The Department will need to persevere in its efforts to bring to completion all the projects that have been initiated.

35.177 The measures taken over the last two years demonstrate a willingness to put into place mechanisms that will help bring about a performance-oriented management culture. Changing management methods and attitudes takes considerable work. It will therefore require a great deal of time and a sustained effort to ensure the success of this initiative.

Observations

The challenges of implementing the new program

35.178 Since our 1995 chapter, the Department has clarified its objectives and priorities. It has established a structured annual planning process that includes communicating the Deputy Minister's objectives and priorities, preparing business plans by each responsibility centre and determining expected results. The planning process has greatly improved over the past two years. However, the Department will need to carry out a more rigorous follow-up of its business plans in order to compare the expected results with those that were actually achieved.

35.179 FORD-Q is currently reviewing its activities and services in the light of the past two years' experience, with a view to specifying them and determining the most efficient delivery methods. In our opinion, the Department needs to take advantage of this opportunity to update the management framework for the IDEA-SME program in order to ensure that its objectives, priorities, services and conditions remain relevant.

35.180 Computerized systems. During our follow-up, we noted that FORD-Q had experienced problems with the installation of two computer systems that are important to the smooth operation and sound management of the program. These were the system used to deliver services and collect data on results achieved (AIDER) and the financial information and contribution management system (G-MAX).

35.181 In the area of program operation, the delivery of non-financial services could be improved, especially in the provision of strategic information and advisory services. Accessing the information is difficult because the computer equipment is not powerful enough. To overcome these deficiencies, the Department has taken a number of steps over the past year. It has added to its computer infrastructure, determined the equipment requirements for its regional offices and begun the process of acquiring equipment. However, it has experienced difficulties in fine-tuning the AIDER system, and this has resulted in several delays in implementation since 1995-96. It is now expected to come on-line by the spring of 1998. The Department appears to have taken the appropriate steps to avoid additional delays and problems, by developing an implementation plan and carrying out periodic follow-up.

35.182 The expectations of management and staff for the AIDER system are very high because of its importance to the efficient delivery of services and the improvement of management information. In light of the considerable sums invested to date to get the system up and running and the difficulties experienced in the past, departmental management will need to continue giving special attention to the implementation of this system. Among other things, management needs to ensure that the required computer equipment is in place at the proper time, that users receive adequate training and that appropriate controls are in place to ensure the accuracy and completeness of the information.

35.183 With respect to program management, FORD-Q has set up a number of mechanisms and systems to manage activities related to IDEA-SME but management does not have available complete and regular management information. In 1995, FORD-Q replaced its contribution management system and experienced various difficulties in extracting data and preparing reports. These problems seem to have been resolved now. Further, the lack of non-financial services data in the system and delays in implementing AIDER have meant that management until now has received little information on the provision of strategic information and advisory services.

The criteria used in analyzing projects remain general

35.184 The IDEA-SME management framework, as it was designed, allows activities and services to be tailored to meet the needs of clients in the Quebec regions. After two years of delivering financial services, the Department has noted a lack of uniformity in the way the procedural requirements for the program have been interpreted and in the thoroughness with which projects have been evaluated. It has already initiated a number of projects, specifically the phasing in of ISO 9002 certification for all the regional offices (designed to standardize all steps in the delivery

of services), and the establishment of a program policy council and working committees to study specific aspects of the program. A study is also under way to identify the procedural requirements and analysis criteria used throughout the regional office network. In our view, the Department needs to use the results from these studies to harmonize its procedural requirements and set out analysis criteria for projects based on the features of the project in question: its nature, the applicant and the amount of assistance involved.

35.185 The Department has taken a first step in determining its risk by setting a range for the loss rates on its repayable contributions, although this range is quite broad (between 35 and 50 percent). The Department needs to specify to a greater degree its expectations in this respect and ensure that project analysis takes into account the possibility of recovering the contributions.

Important steps toward results-oriented management

35.186 FORD-Q has gone to considerable effort in responding to our recommendations on the evaluation of results. It has developed a performance management framework that is applied throughout the Department and that links its mission to its programs and activities and to the impacts that they will have. This overall framework is currently used as a basis for developing performance measurement frameworks for all the Department's activities. The framework for the IDEA-SME program is ready and complete, and the performance indicators are reasonable at this time. The Department plans to gather data on an ongoing basis and to assess the program periodically. At the present time, the continuous collection of data is not a current practice of the Department. The Department is relying heavily on the implementation of the new AIDER system to facilitate this change and to distribute management information using a computerized key performance indicator panel. In addition, the Department has developed a course on performance measurement and evaluation that has been offered to a small group of persons so far. Continuing this initiative should help communicate to staff the importance of measuring performance and results.

35.187 An evaluation policy was to be approved by the fall of 1997. The Department has conducted evaluations of a number of its programs since our audit. We have noted improvements in that both negative and positive consequences have been examined, thereby providing a balanced picture of the effects of the programs that are being evaluated.

35.188 As well, the Department is now presenting performance information in its Part III Estimates, which constitutes an important addition. However, improvements are still required. The reader now sees data but these data are not linked to any pre-established objectives. The reader is therefore unable to judge whether or not the results are acceptable.

35.189 These initiatives require a major cultural change and a long-term effort in order to ensure success. It is too early to conclude that FORD-Q is in a position to analyze the results of its programs and make decisions based on the results obtained. However, the elements that have been put in place reflect major progress toward the implementation of results-oriented management.

Western Economic Diversification Canada — 1995, Chapter 20

Assistant Auditor General: Don Young
Responsible Auditor: Roger Simpson

Background

35.190 Our 1995 audit focussed on the Department's then Western Diversification Program, a program providing financial assistance to business that was designed to diversify Western Canada's economy. We also audited related issues such as collection of repayable assistance, how the Department measures and reports the results of programs, and the roles of the Department's headquarters in Edmonton compared with its Ottawa office.

35.191 We began our audit at a time when the Department had many activities, but its Western Diversification Program was its primary focus. By the completion of our audit, the Program's termination had been announced. Consequently, wherever possible, our recommendations focussed on future programs and the challenges of administering the Western Diversification Program as a significant "legacy" program where both payments for previously approved assistance and collections of repayable assistance would continue for years.

35.192 Our follow-up involved reviewing Western Diversification's status report on action taken. We also reviewed supporting documents and conducted interviews to discuss and assess the extent of progress.

Conclusion

35.193 The Department has taken steps to begin to respond to our recommendations; however, progress to date to address them fully has been slow. To a large extent, this is due to the fundamental changes in programs and structure that the Department has experienced over the last two years. Departmental management estimates that decisions on how to address most of our recommendations will have been made by the fall of 1997.

Observations

Organizational design

35.194 At the time of our audit, Western Diversification had offices in Ottawa and each of the four Western provinces, with central support services in Ottawa. The Department's enabling legislation requires its principal office to be in Edmonton, Alberta. In 1995 we were concerned that there was no analysis by the Department to demonstrate that the staff levels at each location (such as having support staff in Ottawa for a western-based Department) were economical.

35.195 The Department indicated, at the time of our audit, that an examination of administrative functions then under way would help to address our recommendation. The Department more recently indicated that the Deputy Minister's office will be located in Edmonton effective 1 November 1997, and that the future design of the Department should be finalized by the fall of 1997.

Collecting repayments from legacy programs

35.196 Western Diversification's new directions take it away from providing direct financial assistance to business. However, it will have to continue to administer collections under a number of legacy programs, the most significant of which is the Western Diversification Program. The Department estimates that its 1997-98 collections from legacy programs will be \$49 million, declining to \$28 million by 2000-01.

35.197 In 1995 the Department used a combination of its own and full-time contract staff to collect repayments. We recommended that the Department seek ways to minimize collection costs. The challenge remains to collect repayments in a cost-effective manner.

35.198 The Department has considered three collection options:

1. continue to collect repayments internally;
2. sell the portfolio, or have a third party collect it on the Department's behalf; or
3. use some combination of the two.

35.199 The Department rated the collectability of the portfolio, and had informal discussions with third parties with potential interest in the portfolio. Ultimately, the Department decided to negotiate with Revenue Canada, with a view to having it collect repayments on Western Diversification's behalf. Discussions on the matter are continuing.

35.200 As the Department has apparently decided to move to third-party collection of repayments, it needs to finalize the collection arrangements.

Performance measurement and reporting

35.201 General observations. We made a series of recommendations concerning how Western Diversification should establish objectives for its programs, measure their results, and report results to Parliament and others.

35.202 Since 1995, performance reporting in government has assumed a higher profile with the new annual report by the President of the Treasury Board. This report focusses on the importance of measuring and reporting the results of government programs, on individual performance reports by 16 pilot departments and agencies in fall 1996, and on performance reports by all departments including Western Diversification in the fall of 1997.

35.203 Western Diversification faces the challenge of having to assess the performance of a new portfolio of programs. Furthermore, many of these new programs are delivered by third parties on the Department's behalf, which can complicate the process.

35.204 We reviewed a number of departmental documents to determine the Department's readiness to measure and report performance, and guidelines prepared by its Audit and Evaluation Branch that provide a basis for that effort. Other documents, such as a draft Service Partnerships Business Plan and a report on corporate realignment, contribute to its readiness.

35.205 Overall, the Department is moving toward strengthening its capacity to assess and report on performance, but actual performance measurement and reporting activities to date have been few. In our view, however, given the fundamental changes in the Department's programs over the last two years, progress has been reasonable.

35.206 Procurement advocacy. Our 1995 Report also made specific recommendations concerning the Department's reporting of its efforts in advocating the procurement interests of Western Canada in the government's major Crown projects. The Department had reported quantitative information on the West's increase in the share of the "industrial regional benefits" from major Crown projects since Western Diversification's inception.

35.207 We recommended a fuller discussion elaborating on quantitative measures, and enhancing the methodology used to measure and report the benefits of procurement advocacy. Subsequent to our recommendation, Western Diversification ceased publicizing this type of information. Currently, a group of departments involved with procurement are participating in an overall evaluation of the government's industrial regional benefits policy. The evaluation is led by Industry Canada in two phases, with completion of phases one and two planned for fall 1997 and spring 1998 respectively. When completed, the evaluation will presumably allow Western Diversification to report better information on the results of its procurement advocacy efforts.

Industry Canada — Regional Development Programs — 1995, Chapter 21

Assistant Auditor General: Richard Flageole
Responsible Auditor: Peter Simeoni

Background

35.208 In 1995 we examined both of the federal regional development programs for which Industry Canada is directly responsible: the Federal Economic Development Initiative in Northern Ontario (FedNor) and the Canada-Quebec Subsidiary Agreements on Industrial Development.

35.209 Our follow-up work consisted of a review of the Department's reports on its progress in response to our 1995 recommendations. We also reviewed and discussed supporting documentation with the responsible managers.

Conclusion

35.210 We found that the Department has made satisfactory progress in addressing the recommendations we made in 1995.

Observations

FedNor

35.211 The Federal Economic Development Initiative in Northern Ontario (FedNor) was created in 1987 to address the economic disparities and adjustment problems of the region. In 1992 FedNor was extended for five years and the various financial assistance programs were replaced by a single program, the FedNor Business Incentives Program. However, following consultations, in March 1996 the government announced a restructuring of the program. FedNor received a new three-year mandate and a budget of approximately \$60 million. Its strategy covers the following four components: improving access of small businesses to capital, to information and to markets, and promotion of community partnerships. Since the FedNor component audited in 1995 dealt with financial programs, our follow-up focusses on programs for access to capital.

35.212 Program management. In 1995 we recommended development of a streamlined set of guidelines and criteria for assessing applications, differentiated by their size and risk. We also recommended that application documentation be simplified, especially for small projects. Since the restructuring, FedNor now works through partnerships with stakeholders such as financial institutions, community development corporations and the private sector.

35.213 Assistance provided to businesses takes two forms: contributions and loan/investment fund loss reserves. Programs are available both for private companies and for community organizations. FedNor has also set up a number of programs to meet the needs of certain target groups. Accordingly, we are satisfied with the efforts made by FedNor to better segment clients according to their needs.

35.214 Monitoring of projects. We recommended establishment of clear guidelines for monitoring project performance and for reporting project results in the final project report. In view of the creation of new programs and the use of new program delivery mechanisms, we believe it is still too early to determine whether FedNor is adequately monitoring its projects.

35.215 Performance and program evaluation. The recent development of an evaluation framework for the FedNor Business Incentives Program has addressed the recommendation we made in 1995. Management has informed us that it will begin collecting information identified in the evaluation framework to assess performance in late autumn 1997.

Canada-Quebec Subsidiary Agreements on Industrial Development

35.216 The two Canada-Quebec subsidiary agreements were established to co-ordinate industrial development measures of the Government of Quebec and the federal government. The agreements, signed in 1985 and 1992, were to expire on 31 March 1997. In May 1996, it was decided to extend the expiry date by one year. At the same time, the two agreements were merged under the terms and conditions of the second agreement. The few existing projects approved under the 1985 agreement continue to be governed by the terms of that agreement.

35.217 As a result of cuts and other adjustments, federal funding authorized under the two agreements now amounts to nearly \$350 million. At the time of our follow-up, the government had committed nearly all of its funds.

35.218 Documenting support for decisions. In 1995, we looked at documentation in support of funding decisions. We found cases where there was little analysis of key issues. In view of the large sums invested, we recommended that the Department ensure that decisions to fund projects are supported by persuasive assessments in project files.

35.219 Shortly before our audit, Industry Canada was assigned responsibility for managing both of the subsidiary agreements. It had assumed this responsibility previously, from 1985 to 1991, when the Federal Office of Regional Development-Quebec (FORD-Q) took it over.

35.220 Industry Canada has added another level to the project approvals process. This level, the Program and Service Board, is a compulsory step for major projects undertaken under the various departmental programs. The Board, made up of senior departmental officials, is responsible for ensuring that certain specific elements have been examined before approval is given.

35.221 In its July 1997 progress report, Industry Canada stated it is continuing to ensure that arguments in support of the funding recommendations are clearly documented in project files. Departmental representatives told us that the Board's concerns are taken into consideration when the recommendation for project approval is being prepared. Our review of a small sample of files suggests that the documentation supporting project funding recommendations has improved.

35.222 Evaluation of the subsidiary agreements. During our audit, we noted that the first agreement had been renewed and the second agreement signed without a full evaluation of the first agreement having been conducted. We recommended that the Department complete an evaluation of both subsidiary agreements.

35.223 In autumn 1995, the Management Committee responsible for the subsidiary agreements agreed to conduct a joint evaluation of the two agreements in 1996-1997. The evaluation was assigned to a private sector company that was to present a first draft by 31 March 1997. At the time of our follow-up, the final version of the evaluation was about to be approved by the federal and provincial members of the Management Committee.

35.224 Even if the Canada-Quebec agreement is not renewed after 31 March 1998, we believe that the conclusions of the evaluation can be used, as appropriate, for developing other similar programs.

Human Resources Development Canada — Support for Training — 1995, Chapter 22

Assistant Auditor General: David Rattray
Responsible Auditor: Louis Lalonde

Background

35.225 In our 1995 chapter, we acknowledged that major changes in the approach of Human Resources Development Canada (HRDC) to training would likely occur. On 30 May 1996, the Minister of HRDC sent a proposal to the provinces and territories concerning the transfer of responsibility for the design and delivery of active employment measures funded through the Employment Insurance Account. Since then, new Labour Market Development Agreements have been put in place between the Government of Canada and eight provincial governments. The Agreements provide either for decentralization of active labour market measures to provinces (four Agreements) or for co-management (four Agreements). The remaining Agreements are currently under negotiation.

35.226 The objective of the 1995 chapter on support for training was to provide Parliament with reasonable assurance that the Department had established satisfactory procedures to measure and report the effectiveness of its training programs, where procedures could appropriately and reasonably be implemented. We focussed on the training measures found mainly under two employment programs administered by the Department: Employability and Labour Market Adjustment. We also reviewed labour market information activities.

35.227 The chapter expressed some concerns regarding the limited information on current demand/supply conditions in the labour market and on occupational shortages/skills gaps. It also identified shortcomings in the collection of data on training outcomes and in the resource allocation models for training support. In the area of program evaluation, we noted that the majority of evaluations examined were of acceptable quality within their scope. However, we recommended that more emphasis be put on measuring the effects of the training programs in helping to meet the skill needs of the economy, on surplus occupations and on worker mobility. We also highlighted the importance of measuring interprogram effects. Finally, we stressed the need to ensure that departmental evaluations of developmental initiatives address the full range of key evaluation issues and use the most reliable measurement methods possible.

Conclusion

35.228 The new Labour Market Development Agreements have fundamentally changed the way the Department will manage and deliver Employment Insurance-funded active labour market programs in the future. Because of the long-term implications of many of the changes that are now taking place and because several of the agreements are not yet implemented, it will be a while before we can assess their impact and determine the extent to which our recommendations have been addressed. This is particularly true of program evaluations that will be conducted with provinces and territories in the future. We also recommended a model that would incorporate results feedback as a factor in determining budget allocations for training. In the context of the new Agreements, the Department decided not to proceed unilaterally without the support of the provinces and territories and to retain, for the time being, the resource allocation model covering the Employment Insurance Part II base fund. The Department is pursuing discussions with provinces and territories regarding a new resource allocation model.

35.229 We have concluded that the Department has made substantial progress in many of the areas that we audited in 1995. For instance, in the area of results measurement, it has implemented new systems that will generate more information on the performance and outcomes of active labour market programs. The Department has also taken significant steps to improve labour market information and is now collecting and publishing information on current labour market conditions. Finally, the Department has indicated that it would undertake an assessment of projections of labour market demand and supplies and that it would make these measurements on a regular basis.

Observations

Labour market information

35.230 The development of information systems on current and future labour market conditions for various occupational groups and regions is important in various situations; these include career counselling, educational planning, and the development of active labour market programs.

35.231 Under the new arrangements, the federal government retains overall responsibility for the development of labour market information, although some provinces have now assumed some responsibilities in this area. Until all the Agreements are finalized and implemented, how these responsibilities will be shared will remain unclear. However, HRDC will likely remain a significant producer and provider of labour market information. For instance, it is committed to publishing, on a more frequent basis, *Job Futures*, a detailed compendium of information on economic conditions that face newcomers to various occupational groups. This product is one of the significant outputs of the Canadian Occupational Projection System (COPS).

35.232 In 1995, we noted the lack of comprehensive ongoing information on current occupational demand and supply conditions in the Canadian labour market, especially in terms of prevailing trends in skill shortages. Since 1995, the Department has revised the COPS methodological framework, in order to make it capable of providing labour market information on prospective future occupational imbalances between demand and supply. Together with this important first step, another positive development in this area is the production by the Department of information on current labour conditions. HRDC publishes this information in *Job Futures* in the form of qualitative ratings.

35.233 In our 1995 audit, we identified the need for the Department to conduct an analysis of causal factors related to skill shortages. The Department still does not produce such analysis. We also noted that the Department intends to establish a link between the experience of those who have recently left school and the current occupational labour market situation for the occupations in which graduates generally find jobs. We therefore encourage the Department to do the same for graduates of federally sponsored active labour market programs in order to help determine the effectiveness of such programs.

35.234 Finally, in 1995, we also concluded that COPS forecasts should be compared with what actually occurred and an analysis of the variances between the two should be undertaken. The purpose in this instance was to provide a tracking of the reliability of COPS, with a view to improving its usefulness and more clearly identifying labour market adjustment processes. The Department has stated its intention to proceed with an assessment of its forecasting record sometime past the midpoint of its first forecasting period (using 1995-98 data) and to implement these performance procedures on a regular basis thereafter.

35.235 Although there has been encouraging progress, we are concerned about the limitations of current information on the above-noted occupational imbalances in the economy. Our 1995 audit stated that a program evaluation undertaken by the Department in 1991 estimated, from an employer-based survey, that during the 1988 to 1990 period there were 300,000 hard-to-fill vacancies annually. We also noted in our 1995 audit that the lack of causal analysis in this area generates a risk that the federally sponsored training activities may not adequately

respond to the economy's skill needs; as a result, the effectiveness of such active labour market programs in improving the employability of workers and lowering unemployment levels may be reduced.

Results measurement

35.236 In our 1995 audit, we observed that ongoing feedback on cost effectiveness was lacking, that measures for monitoring operational results were not fully implemented and that data reliability problems had been recognized.

35.237 The Department has taken some steps to address our concerns and has developed information systems that will collect data with the intention of facilitating client documentation, increasing the capacity to collect and report data on employment results, increasing efficiency and improving the reliability of information. For this purpose, the Department has developed several projects.

35.238 One project that has been implemented is Contact IV, a case management service delivery microcomputer system that is operational in approximately 860 third-party agencies providing employment services to HRDC clients. It facilitates documentation of client information and employment data for accountability and reporting purposes. A similar system, called Window Ness (NESS-GUI), has been developed for internal and provincial staff clients. The Department is also in the process of developing the Human Resources Investment (HRI) Client Data Set, which will provide national headquarters, regions and Human Resources Centres of Canada with consistent management information on clients who participated in various HRI activities. The integration with financial systems is presently under development. Once completed, it will allow the monitoring of unit costs per trainee.

National allocation of program resources

35.239 We observed in 1995 that the national resource allocation models did not take account of results feedback. We recommended that such information be used as a factor to allocate resources. The federal proposal to provinces and territories for a new partnership in the labour market, released 30 May 1996, stated that the allocation of funding would be equitable, transparent and based on a standardized set of objective labour market variables. HRDC subsequently decided that it would work in concert with the provinces and territories to develop a new mutually agreed-on formula for the interprovincial allocation of the Employment Insurance Base Funding rather than proceed in a unilateral fashion. For the time being, the allocation of Employment Insurance funds continues to be based on the existing formula that has been in place over the past several years and about which we identified a number of concerns in 1995.

35.240 The Department is pursuing discussions with provinces and territories in this regard. Most of the Labour Market Development Agreements reference the possibility of a multilateral process for the review of the Employment Insurance resource allocation formula. Under the federal-provincial/territorial Forum of Labour Market Ministers (FLMM), jurisdictions have agreed to place the review of the Employment Insurance formula on the Forum's 1997-98 workplan. HRDC is the federal co-chair for the multilateral review process, while the FLMM has designated Ontario as provincial co-chair. The Department indicated that parties will be working together starting in fall 1997 to determine an appropriate process, options and timetable for implementation.

Program evaluation

35.241 In 1995, we noted that the majority of the evaluations we examined were based on analytical frameworks that were reasonable and appropriate; however, we recommended that the Department intensify its efforts and obtain regular feedback on the effectiveness of training activities. More specifically, we highlighted the need to measure and report the effects of training programs in helping meet the skill needs of the economy, and the effects of its support of training in surplus occupations. We also emphasized the need to examine skill levels of trainees before and after training and the effects of training on worker mobility in high unemployment regions. Finally, we identified a need to analyze and report on the interprogram effects of training and other programs.

35.242 Under the new Labour Market Development Agreements, HRDC and its provincial partners have agreed to conduct evaluations of program effectiveness based on the Agreements. The Agreements outline the obligation to develop evaluation frameworks that will guide the development of evaluation processes adhering to recognized evaluation practices. The Department has already developed guidelines outlining the core federal issues for the formative and summative evaluations and shared these with the provinces to initiate a collaborative evaluation process. These guidelines address the relevance, design, delivery, success and cost-effectiveness of the programs and services provided under the Agreements.

Indian and Northern Affairs Canada — On-Reserve Capital Facilities and Maintenance — 1995, Chapter 23

Assistant Auditor General: Don Young

Responsible Auditor: Grant Wilson

Background

35.243 In November 1995, we reported observations and recommendations on capital facilities and maintenance funded by Indian and Northern Affairs Canada for Indian reserves. The facilities included water treatment and delivery systems, schools, roads and electrification. We recommended that improvements be made in several areas, including the way the activities were planned, funded and delivered.

35.244 Capital facilities and maintenance continue to be a stated priority of the Department in its efforts to improve living conditions on reserves across Canada. The applicable 1997-98 budget is \$806 million.

35.245 The objectives of our 1997 follow-up were to determine the status of the 1995 recommendations, to identify emerging improvements, and to note any significant other matters that came to our attention.

35.246 Accordingly, we reviewed and tested the May 1997 status report provided by the Department on its progress in implementing recommendations. We considered all the reported action and focussed on selected aspects of project planning, implementation and evaluation in a major region of the Department. These aspects offer good opportunities to achieve better value for money while improving living conditions on reserves. We also inquired into current maintenance practices.

35.247 The follow-up included a review of 13 capital facilities projects having a cumulative value of approximately \$43 million. The region classified these as “major capital” projects.

Conclusion

35.248 Most of the Department’s efforts since 1995 have focussed on internal studies and reviews to help identify how improvements can be achieved. However, our review of selected capital facilities projects and related matters disclosed no significant improvements from key findings in 1995.

35.249 Furthermore, additional concerns were noted in the region about the lack of agreement between the Department and First Nations on whether bid tendering should be used to select construction contractors.

35.250 We encourage the Department to implement the applicable recommendations fully and expeditiously and to resolve the issue of bid tendering. This should help the Department obtain assurance that good value is achieved for the funds provided and that improvements in living conditions on reserves are realized.

Observations

Results of project reviews

35.251 The purpose of reviewing 13 major capital projects was to identify any emerging improvements (or deterioration) in project planning, implementation and evaluation since the 1995 audit.

35.252 Overall, the audit sample disclosed no significant change from the findings reported in 1995. For example, improvements are still needed in such areas as project risk assessments, monitoring, evidence of project completion and evaluation of project results.

35.253 A case example of additional issues is reported separately in Chapter 36 — Other Audit Observations.

Maintenance problems remain

35.254 In 1995 we reported that the Department did not have the necessary assurance that maintenance funds were being used for the intended purpose and that maintenance of capital assets was performed appropriately. We also reported that the risks of inadequate maintenance are significant.

35.255 Up to an estimated \$270 million, or one third of the annual capital facilities and maintenance budget, is allocated to maintenance. Proper maintenance is needed to obtain appropriate levels of service from the asset and to avoid premature and costly recapitalization. We therefore expected timely action from the Department to address the 1995 audit concerns.

35.256 An early 1997 internal assessment of operations and maintenance on reserves by a regional office of the Department raised several concerns, including:

- the lack of training and expertise in some First Nations to maintain assets;
- frequent turnover of maintenance personnel;
- the lack of incentive for First Nations to properly maintain assets; and
- the lack of a requirement for maintenance plans under certain funding arrangements with First Nations.

35.257 Under devolution, the Department continues to rely on First Nations community plans for any identified maintenance requirements. While the appropriate use of these plans can be beneficial, this approach alone may not be sufficient in every case because of the diversity of about 600 First Nations.

35.258 In June 1997, the Department issued draft compliance guidelines for the operation and maintenance (O & M) of capital assets on reserves. The purpose of the guidelines is to help ensure that O & M funds are used for the intended purpose, that the condition of the facilities is assessed annually and actioned where required, and that advice and assistance on maintenance are provided to First Nations. Full implementation of the guidelines is targeted for fiscal year 1998-99. In our view, the Department has not acted quickly enough to address this important issue.

Departmental action to May 1997

35.259 The Department reported that it had partially implemented all of the 1995 audit recommendations. Through its analysis of each recommendation and ongoing reviews of current policies, practices and evolving issues, the Department expects that most of the work remaining for full implementation will be completed by March 1998.

35.260 According to the Department, various efforts to address the audit concerns and management needs are in progress or have been completed, including the following:

- An internal audit was conducted to assist managers in implementing improvements.
- Training programs were developed and expanded for First Nations water and sewer operators.
- A national workshop for departmental officials was held to discuss several capital management issues.
- Service standard levels are being revised.
- Operational targets are being updated.
- A study is under way to revise the Department's Cost Reference Manual to ensure comparability between on-reserve and other communities.
- Draft compliance guidelines have been issued to regions to address operating and maintenance issues.

35.261 Some documentation supporting these initiatives, such as draft compliance guidelines for the operation and maintenance of on-reserve capital assets, was issued toward the end of our follow-up audit. A proposed paper on funding allocations and the proposed Real Property Service Report on the Capital Asset Inventory System were still under development when we completed the follow-up and were not available for our review.

Bid tendering issues need resolution

35.262 During the follow-up, the issue of bid tendering for capital construction projects came to our attention. The issue includes the difficult challenge to the Department and First Nations of balancing lowest procurement costs, acceptable performance and socio-economic benefits to First Nations.

35.263 The devolution of program delivery to First Nations has been increasing for many years. In construction of capital facilities, First Nations generally select the contractors to be used. The current policy of the Department requires that First Nations use public tenders where the estimated construction costs of a project exceed \$500,000. However, this approach is not supported by a First Nations technical group that believes that value for money, including spinoff benefits to the community, can be achieved through means other than public tendering.

35.264 We are concerned that unresolved tendering issues can lead to unnecessary increased costs in the delivery of capital projects. A case illustration of tendering issues is reported separately in Chapter 36 — Other Audit Observations.

35.265 The Department has indicated that general principles to guide a First Nations tendering policy will be issued by March 1998.

Department's response: Following the release of the November 1995 audit on the On-Reserve Capital Facilities and Maintenance Program, Indian and Northern Affairs Canada developed an action plan that resulted in progress on each area of the recommendations made by the Auditor General. There are numerous initiatives currently under way, most of which will be completed by 31 March 1998. The Department will continue to work expeditiously toward the effective implementation of the applicable recommendations.

In particular, the Department has articulated its strategy for ensuring that on-reserve assets are properly operated and maintained through the issuance of an operations and maintenance compliance regime. The regional staff will work with First Nations to ensure full implementation by 31 March 1998. The Department believes that the time required to develop and implement this regime was appropriate due to the need to undertake regional consultation and collect the necessary data. In addition, the Department is working with First Nations in order to strengthen accountability to both First Nations communities and to Parliament. To achieve this, each First Nation and Tribal Council funded by the Department is required to complete an assessment of its accountability and management system by 31 March 1998.

The Department recognizes the need to work with First Nations to implement the policy requirement for First Nations to use a tendering process for capital projects over \$500,000, excluding housing. In implementing this policy, the Department is faced with the challenge of achieving a balance between the concepts of achieving best value for federal funds and increased socio-economic benefits for First Nations. The Department is working on a paper to define general principles for guiding First Nations tendering policies.

Important progress has been made toward improving living conditions on-reserve and the Department is well positioned to continue this progress while at the same time ensuring value for money.

Chapter 36

Other Audit Observations

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Other Audit Observations

Main Points

36.1 The *Auditor General Act* requires the Auditor General to include in his Reports matters of significance that, in his opinion, should be brought to the attention of the House of Commons.

36.2 The “Other Audit Observations” chapter fulfils a special role in the Reports. Other chapters normally describe the findings of the comprehensive audits we perform in particular departments; or they report on audits and studies of issues that relate to operations of the government as a whole. This chapter reports on specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

36.3 The chapter normally contains observations concerning departmental expenditures and/or revenues. The issues addressed generally involve failure to comply with authorities, and the expenditure of money without due regard to economy.

36.4 Observations reported this year cover the following:

- information to Parliament on the use of “special measures” falls short of legislative requirements and Parliament’s needs;
- an initiative to provide spare parts failed to maximize its potential cost-saving benefits;
- escalating costs of a water supply project were not adequately justified;
- lack of compliance with a funding arrangement resulted in questionable costs;
- an \$801 million payment raises concerns over accountability requirements;
- the design and construction of a facility illustrates a “build [up] to budget” approach that does not encourage cost savings; and
- departmental standards and practices were not followed in awarding a duty free shop licence.

36.5 Although the individual audit observations report matters of significance, they should not be used as a basis for drawing conclusions about matters we did not examine.

Introduction

36.6 This chapter contains matters of significance that are not included elsewhere in the Report and that we believe should be drawn to the attention of the House of Commons. The matters reported were noted during our financial and compliance audits of the Accounts of Canada, Crown corporations and other entities, or during our value-for-money audits.

36.7 Section 7(2) of the *Auditor General Act* requires the Auditor General to call to the attention of the House of Commons any significant cases where he has observed that:

- 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;
- 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;
- money has been expended other than for purposes for which it was appropriated by Parliament;
- money has been expended without due regard to economy or efficiency;
- satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

36.8 Each of the matters of significance reported in this chapter was examined in accordance with generally accepted auditing standards; accordingly, our examinations included such tests and other procedures as we considered necessary in the circumstances. The matters reported should not be used as a basis for drawing conclusions about matters not examined. The instances that we have observed are described in this chapter under the appropriate department headings.

36.9 Consistent with Office policy on the follow-up of matters in our Reports, other audit observations included in this chapter are normally followed up two years after initial reporting. Three observations were included in our 1995 Report. In our follow-up of these observations, we found that in one case corrective action had been taken to address the matter. In another case, follow-up was not required since we did not consider the matter to be an outstanding issue. One observation remains outstanding because it involves matters that we are continuing to monitor, and any lack of corrective action will be reported as deemed appropriate.

Agriculture and Agri–Food Canada

Information to Parliament on the use of “special measures” falls short of legislative requirements and Parliament’s needs

Assistant Auditor General: Don Young
Responsible Auditor: Neil Maxwell

Agriculture and Agri–Food Canada has used a “special measures” section of the Farm Income Protection Act (FIPA) to authorize a new class of safety net programming called provincial “companion programs”. About \$415 million has been committed to these programs to date. The Department has not been in compliance with section 12(7) of the FIPA, which requires that each use of these special measures be authorized by an order–in–council tabled in Parliament. Since August 1995, more than 30 different programs have been so authorized to deal with “exceptional circumstances”, but none of the orders–in–council have been tabled. A substantial number of these orders were issued more than one year ago.

To provide a reasonable basis for parliamentary oversight and control, the Department should provide additional information about the objectives, costs and results of these programs, in conjunction with tabling the orders–in–council required under section 12(7) or by other means.

Background

36.10 The *Farm Income Protection Act (FIPA)* was enacted in April 1991. The Act provides for the creation of “safety net” programs by authorizing “agreements between the Government of Canada and the provinces to provide for protection for the income of producers of agricultural products and to enable the Government of Canada to take additional measures for that purpose.”

36.11 Section 12 of the *Farm Income Protection Act* is titled “Special Measures”, and subsection (1) provides:

Where the Minister is of the opinion that **exceptional circumstances** [emphasis added] exist that require that action be taken outside the scope of a program established under an agreement, the Minister may implement such procedures or other special measures as the Minister considers necessary to determine the appropriate action to be taken to remedy those circumstances ...

36.12 This section of the *FIPA* gives the Minister discretion to determine whether “exceptional circumstances” exist and to identify the specific actions he or she considers necessary to deal with them. These actions are given legal authority through the issuance of orders by the Governor in Council under section 12(5) of the Act.

36.13 Because actions taken under section 12 are outside the scope of established safety net programs, Parliament included a requirement under section 12(7) to ensure that it would be kept informed of any use of these “special measures”. Subsection (7) states that every order taken under section 12(5) shall, “**as soon as possible**” [emphasis added] after it is authorized, “be laid before each House of Parliament.”

Issues

36.14 At 1 October 1997, more than 30 provincial “companion programs” had been authorized by the Governor in Council pursuant to section 12(5) of the *FIPA*. Companion programs are province-specific agreements designed to enhance existing national safety net programs like the Net Income Stabilization Account and Crop Insurance. They are one element of the safety net framework negotiated with the provinces, and are intended to address region-specific needs. About \$415 million has been committed to these programs to date.

36.15 However, at 1 October 1997, none of the orders-in-council issued under 12(5) to authorize these programs had been laid before either House of Parliament, as required by 12(7). This control, although “after-the-fact”, is an important tool for parliamentary oversight. In particular, it identifies for parliamentarians, in a timely fashion, any use of the “special measures” provisions of the *FIPA*.

36.16 In its Estimates for both 1996-97 and 1997-98 and in its 1996 Performance Report, the Department has indicated that a new framework for safety net programming is now in place, and that companion programs are a major component of that framework. The 1996-97 Estimates included a description of broad categories of companion programs. However, Parliament has not received any detailed information about objectives, costs and results of the companion programs — information that is essential to any meaningful oversight role.

36.17 There are several factors associated with these companion programs that highlight the need for additional reporting to Parliament:

- the existence of “exceptional circumstances” and the extensive use of special measures under 12(5), which by themselves warrant being brought to Parliament’s attention;
- the significant financial commitment involved;
- the “pilot-like” nature of many of these companion programs, which address areas outside the scope of traditional safety net programs (e.g. adaptation, innovation, research and development); and
- the impact these companion programs are expected to have on the design of the next generation of safety net programs coming on-stream in the 1999-2000 fiscal year, for which the consultation process is just beginning. Some form of reporting on the preliminary results achieved from the companion programs would obviously be pertinent to those consultations.

36.18 We think Parliament needs a concise, complete listing that provides summary information about program objectives, costs, expected results, how results will be measured and completion dates. The fact that, apart from 12(7), there are no specific legislative reporting requirements for the “special measures” gives the Department considerable flexibility to choose the vehicle or vehicles it feels are most appropriate for providing the necessary information. These could include the Department’s Estimates Part III, its Performance Reports or presentations to the Standing Committee on Agriculture and Agri-Food, as well as providing this information in conjunction with the tabling of the orders-in-council under 12(7). The nature, extent and timing of the information to be provided are all important considerations in assisting Parliament in its oversight role.

Conclusion

36.19 To date, Parliament has not been provided with an adequate information base for oversight and control of the series of companion programs recently authorized under the “special measures” provisions of the *FIPA*. To provide the necessary information, the Department should table before Parliament all orders-in-council issued

under section 12(5) of the *FIPA*, as required by section 12(7). In addition, it should provide Parliament with timely and relevant information about the objectives, costs and expected results of the companion programs and, in due course, their actual results, in conjunction with the tabling of orders-in-council under 12(7) or by other means.

Department's response: Agriculture and Agri-Food Canada (AAFC) shares the Auditor General's commitment to improving the quality and timeliness of information provided to Parliament. That is why AAFC was among the 16 departments and agencies that volunteered to participate in the Improved Reporting to Parliament Project. This pilot project resulted in the recent tabling of fall Performance Reports.

AAFC acknowledges its obligation under section 12(7) of the Farm Income Protection Act (FIPA) to table all orders-in-council pursuant to section 12(5). The Department's preference would have been to lay before Parliament a complete package pertaining to all federal-provincial companion programs since these have been developed as a set. There are still some agreements under negotiation. Nonetheless, in light of the concerns of the Office of the Auditor General (OAG), the Department has initiated a process to table existing orders-in-council as soon as possible.

The Department looks forward to continuing to work co-operatively with the OAG and other stakeholders to improve parliamentary reporting practices.

Fisheries and Oceans / Coast Guard

Assistant Auditor General: Shahid Minto
Responsible Auditor: Reno Cyr

An initiative to provide spare parts for the Louis S. St. Laurent icebreaker has failed to maximize its potential cost-saving benefits

In 1996, we found significant deficiencies in the government's materiel management practices, including buying and stocking inventories of items that were readily available commercially. Our current audit illustrates the challenges posed when adopting new management practices. Since December 1994, the Coast Guard has taken a new approach to acquiring spare parts for the Louis S. St. Laurent icebreaker, and has now paid over \$300,000 to a private sector supplier to stock an inventory of engine spare parts. The spirit and intent of this initiative are consistent with the objectives of better service at less cost; however, it appears that neither of these objectives is being maximized. In 1994, the contract was entered into without adequate analysis. In 1996, a new contract did not reflect changes in requirements. In our opinion, to obtain better value for money for the Crown, the Coast Guard needs to re-examine the provisions of this agreement in light of past performance and the current operational requirements of the vessel.

Background

36.20 The Fisheries and Oceans/Coast Guard Icebreaker Louis S. St. Laurent (the Louis), Canada's largest and most powerful icebreaker, was built in 1969. In 1988, the Canadian Coast Guard delivered the Louis to a shipyard for a midlife modernization project that included a 20-year life extension. In 1993, the ship re-entered service following the problematic modernization project, in which the total cost escalated from an effective project approval of \$75.8 million in 1987 to about \$159 million. We reported on the midlife modernization issues in 1990.

36.21 In our November 1996 Report chapter, Materiel Management in the Federal Government, we noted significant deficiencies in the government's materiel management practices. Departments were holding excessive quantities of items that had to be stocked, as well as items that were readily available commercially and did not have to be stocked. We became aware of this Coast Guard initiative during the 1996 audit.

36.22 The Coast Guard took a new approach to acquiring genuine replacement spare parts and technical support for the German-manufactured diesel engine propulsion units of the Louis. Rather than the traditional approach of purchasing a complete set of spare parts and incurring holding costs to store them itself, the Department entered into a life-cycle support agreement with the supplier of the engines to provide these services for a basic monthly holding fee plus the cost of any parts used. The intended benefits to the Coast Guard of this arrangement included no up-front capital investment in spare parts, no direct holding costs, no risk of obsolescence, and delivery within 24 to 48 hours of genuine replacement parts when needed, resulting in minimum downtime of the vessel on operational taskings.

36.23 In our opinion, before entering into such an agreement, the participants must have a good knowledge of the costs and clearly articulated performance expectations. Once a contract is signed, there needs to be ongoing monitoring of performance and refinement of requirements based on the experience gained. In the case of this initiative, we found neither.

Issues

36.24 Lack of adequate analysis prior to entering into a contract. The Louis was expected to be heavily tasked after completion of the costly modernization project; quick response times to mechanical breakdowns would be necessary to maintain a high level of operational readiness.

36.25 In December 1994, the Coast Guard entered into an agreement under which it would pay the supplier approximately \$5,600 per month to hold specific items in storage at the company's Canadian warehouse, for the exclusive use of the Louis. Neither the Coast Guard nor Public Works and Government Services Canada, who negotiated the agreement, could clarify for us the basis and justification of the supplier's \$5,600 monthly fee for its services. The supplier did provide a rationale for pricing based upon a percentage of the inventory held, but it was found to be weak and lacking in detail. We also noted the absence of any risk analysis by the Coast Guard to establish the need to hold various types of spare parts. In our opinion, those parts that could be purchased through the supplier's normal commercial channels would not need to be held and incur holding fees.

36.26 The supplier's literature advertises a worldwide sales and service organization that ensures around-the-clock customer satisfaction through well-equipped spares depots in the main markets. In addition, the supplier has a central spares depot in Germany with approximately 96 percent of all engine parts in stock, and claims that more than 80 percent of orders received in the morning are filled the same day. The scope of our audit did not include verifying these claims. We have been informed by the supplier that it does not maintain a dedicated stock, such as that for the Coast Guard, for its other commercial clients.

36.27 We support the Coast Guard's initiative in trying a new approach to providing spare parts. However, we would have expected that before entering into such a contractual arrangement, the Coast Guard, with the support of Public Works and Government Services Canada, would have conducted a thorough analysis to determine whether the arrangement would be beneficial to the Crown. This would include estimating the costs and benefits of all available options. We found no evidence of such an analysis.

36.28 New contract does not reflect changes in requirements. In January 1996, a new contract was signed that extended the agreement to 30 May 1999. The contract increased both the total value of the spare parts held by the supplier (from about \$570,000 to about \$920,000) and, commensurately, the monthly holding fee (from about \$5,600 to about \$10,300). We found inadequate information to support the increase in the monthly fee and no rationale for the increase in inventory. Prior to signing the new contract, an internal report by a Public Works and Government Services Canada cost analyst had raised similar concerns about the justification of the monthly fee.

36.29 The significant increase in the spare parts inventory came at a time when the Louis was being underutilized. Coast Guard records indicate that since its redeployment following the modernization project, the Louis has been tasked less than 50 percent of its available time. On occasion, there have been lengthy periods of time between taskings. Coast Guard officials have stated that the engines' performance has been better than specifications and that the contractor's service record has been excellent.

Conclusion

36.30 We found no program of monitoring the usage rates and operational taskings as a basis for refining the appropriate levels of inventory of spares held. In our opinion, since signing the contract in 1994, the Coast Guard has not performed sufficient monitoring and analysis to manage and refine the level of spare parts held in order to obtain best value for the Crown. We would expect to see an analysis identifying the minimum inventory of spare parts needed to be held for the Louis, taking into account the worldwide availability of parts from the supplier.

36.31 Subsequent events. In the spring of 1997, during the conduct of our audit fieldwork, we expressed our concerns to the Coast Guard about the size of the inventory and the monthly fees paid. The opportunity to revise the contract on its renewal date in June 1997 was missed. In September 1997, the Coast Guard informed us that the contractor's inventory had been reviewed and a reduction of \$156,000 had been identified for the period June 1997 to May 1998. The Coast Guard acknowledges that this information was not forwarded to the contractor by the June renewal date, but it believes that an interim adjustment will be negotiated. We believe that this has resulted in additional needless expenditures and poor value for money for the Crown.

Department's response: As at 4 November 1997, inventory levels had been reduced by \$156,000 as identified by the Auditor General. The Department will continue to reduce holdings, with the ultimate goal being "just-in-time" delivery of spare parts. These reductions will be based upon analysis of data from upgraded machinery and inventory monitoring programs now in place, in conjunction with the demonstrated delivery track record of the propulsion system contractor and the contract further adjusted accordingly.

Given the remote area of deployment, the Department followed a prudent course of action in treating the serviceability claims of the manufacturers with cautious optimism. The soundness of this approach has been confirmed by the stellar performance of the vessel to date, meeting every challenging demand and setting many new records in Arctic navigation.

This objective is an integral part of the maintenance management philosophy of the Department to maintain a high level of performance at minimum cost.

Indian and Northern Affairs Canada

Assistant Auditor General: Don Young
Responsible Auditor: Grant Wilson

Escalating costs of on-reserve water supply project not adequately justified

A water supply development project, funded by Indian and Northern Affairs Canada, was undertaken on a reserve because of contamination in a river used as a source of treated drinking water. Estimated costs of the project, currently in progress, increased significantly in less than two years. Preliminary project approval by Indian and Northern Affairs Canada in September 1995 was \$1 million. By April 1997, the revised planned cost had climbed to \$2.3 million, more than twice the original estimate. Furthermore, the Department was aware that according to an engineering consultant engaged by the First Nation, the contamination could have been treated by improving the existing water treatment plant at an estimated cost of \$26,000.

Background

36.32 Adequate drinking water is an important priority for Indian reserves across Canada and for Indian and Northern Affairs Canada in its funding of on-reserve capital projects. It is especially important that adequate water be made available in a cost-effective way, because resources are limited and the needs are considerable.

36.33 During the follow-up of our November 1995 Chapter, Indian and Northern Affairs Canada: On-Reserve Capital Facilities and Maintenance (see Chapter 35 of this Report), we observed the following case.

36.34 In March 1993, a First Nation community of about 400 reported its concerns to the Department regarding contamination in the community's drinking water sourced from a river. In the same month, a study by an engineering consultant engaged by the First Nation identified deficiencies in the existing on-reserve water treatment plant and its operation. The estimated cost to improve the plant and the quality of water was \$26,000 for an expected population of 700 by year 2000. Other considerations for longer-range needs and fire control were identified but not costed.

36.35 In May 1993, the Department noted that tests of treated water at the treatment plant showed a higher concentration of aluminum than that found in tests of river water. According to the Department's Technical Services, the problem appeared to stem from the water treatment plant. In September 1993, the Department recommended that the First Nation improve the treatment plant. In May 1994, the First Nation reported to the Department that the funds provided to it by the Department to repair the plant and to cover an interim supply of bottled water were inadequate.

36.36 According to the Department, the First Nation had lost confidence in the river as a source of potable water and insisted on establishing a new source of supply. In September 1995, the Department gave preliminary approval to the First Nation's proposal for a \$1 million project to develop a new source of water on the reserve.

Issues

36.37 Our review of this project disclosed that the approach and scope of the work changed significantly over time. The approach recommended in the March 1993 study to improve the treatment plant and its operations at a

cost of \$26,000 would provide for continued use of the river as a source of drinking water. Although the Department indicated that it had provided \$30,000 to the First Nation to implement the study's recommendations, no evidence was available in the Department to show what improvements had been made with these funds.

36.38 At various times, up to preliminary approval in September 1995 and subsequently, several technical issues and options were discussed for establishing an alternative supply of drinking water. For example, in May 1995 another engineering consultant engaged by the First Nation proposed four options for developing a new source of raw water. However, none of the options included a cost analysis of continuing to use the river as a source.

36.39 One of the options was selected at a proposed cost of \$1 million. This involved constructing three wells as a new source of supply, which were intended to service a community of 800 expected by 2025. However, this approach was abandoned, and under a proposal in November 1996 by yet another engineering consultant engaged by the First Nation, approval was given to construct five new wells in another location. This included the necessary water mains and related facilities for \$1.6 million. The estimated cost increased to \$2.3 million by April 1997, including the cost of treating other identified contamination associated with the new location. By this time, over \$1 million had been spent on or committed to this project.

36.40 We believe that significant issues were not adequately resolved before the decisions were made to proceed with and expand the project. These include the following:

- The Department failed to ensure that identified problems in the existing treatment plant were remedied and that funds provided to the First Nation for this purpose were used appropriately.
- The Department did not adequately take into account the contamination relating to the wells before committing to this approach.
- The Department accepted analyses of four options submitted by the First Nation, which excluded the river as a water source option. This was despite the Department's knowledge before approving the project that the river could be a viable source of water, properly treated in the existing plant, and that plant improvements could be achieved for only nominal cost.
- We could find no life-cycle cost analysis that compared the estimated \$2.3 million cost of the selected project, to service the estimated needs of a projected population of 800 by 2025, with a \$26,000 cost to improve the existing plant for a projected population of 700 by 2000. We would expect an analysis to have disclosed the assumed benefits and costs of the alternatives, including consideration of the river as a continued source of treatable water.

Conclusion

36.41 Accordingly, we concluded that there was inadequate justification for the cost escalation in this project. Given the considerable demand for improvements to on-reserve capital facilities, we believe that other worthy projects may have been adversely affected because of the cost escalation in this project.

Department's response: The First Nation had serious concerns regarding the contamination of their water supply. Those concerns were subsequently confirmed with Health Canada. The Department worked with the First Nation to ensure that the community had access to safe, reliable drinking water.

The Department carefully examined potential options to solve the water quality issue, including retrofitting the existing plant, but ultimately other alternative sources had to be examined. The options considered needed to address the concerns of the community carefully and provide them with an appropriate source of water.

Given the circumstances involved in this particular case, the Department feels that it took a reasonable approach in providing a safe, reliable source of drinking water in a cost-effective manner, taking into consideration the concerns of the community. The project is expected to be put into operation in November 1997.

Indian and Northern Affairs Canada

Assistant Auditor General: Don Young
Responsible Auditor: Grant Wilson

Lack of compliance with funding arrangement results in questionable costs and benefits

During the fiscal year 1996-97, Indian and Northern Affairs Canada approved an \$8.9 million on-reserve infrastructure project to be constructed by a First Nation. As of March 1997, the Department had allocated \$3.5 million toward the project. A condition in the project funding arrangement between the Department and the First Nation requires that the First Nation call for public tenders of all construction contracts.

Instead, according to the Department, the general contractor selected by the First Nation was awarded the contract on a negotiated fixed-price basis. Furthermore, a departmental project risk analysis determined that the lack of tendering and the selection of the chosen contractor resulted in estimated extra costs ranging from \$700,000 to about \$1 million. The analysis also estimated other risks at \$594,000, although this amount might have been applicable to any contractor selected. The Department indicated that the extra costs and risks were offset by socio-economic spinoff benefits to the community. However, the Department could not adequately demonstrate the basis for the offset.

Background

36.42 During the follow-up of our audit reported in Chapter 23 of the November 1995 Report, Indian and Northern Affairs Canada: On-Reserve Capital Facilities and Maintenance, we noted unresolved issues regarding bid tendering (see Chapter 35 of this Report). The following case came to our attention.

36.43 A major capital construction project to provide water and sewer services on a reserve was approved by the Department for \$8.9 million during the fiscal year 1996-97. As of March 1997, the Department had allocated \$3.5 million to the First Nation for this project, which was still in progress at the time of our audit.

36.44 Under the funding arrangement between the Department and the First Nation, public tendering is required for all construction contracts to ensure prudence, probity, sound contract management, and best value, which may include consideration of opportunities to secure socio-economic benefits for the community. Instead, public tendering was not used to select the general contractor, which was awarded the project by the First Nation for a negotiated fixed price of \$8.9 million.

Issues

36.45 According to the Department, the general contractor was an incorporated company formed just prior to the project and owned by the same First Nation that received approval and funding for the project. A departmental project risk analysis estimated that the extra cost to the project arising from the lack of tendering was about \$700,000. Additional potential costs attributable to the inexperience of the selected contractor and to related matters were estimated at \$358,000, bringing the estimated cost and risk premium to about \$1 million. Other project risks were estimated at \$594,000, which, according to the Department, might have been applicable to any selected contractor. The Department indicated that all of these costs were included in the approved amount of \$8.9 million. The First Nation indicated that in its view, there were no extra costs and risks attributable to the selection of the contractor as described in the Department's analysis.

36.46 The Department stated that the extra costs and risks incurred in the fixed price award to the general contractor were offset by socio-economic spinoff benefits, deemed to be \$2.4 million. We believe that project spinoff benefits and the premium paid to achieve them should be supported by an appropriate analysis that determines, among other things, the value of benefits by type and their expected duration. Assumptions used for each benefit also need to be clearly stated, consistent with supporting rationale. However, during our review, the Department could provide no analysis to support the deemed benefits. The First Nation reported that community spinoff benefits were achieved and, although it did not quantify them, did not agree with the deemed value of \$2.4 million.

Conclusion

36.47 The Department failed to comply with the conditions of its funding arrangement. The tendering requirement was not enforced by the Department and tenders were not called for by the First Nation as required. In our opinion, non-compliance by the parties does not augur well for effective implementation of the arrangement. Furthermore, in the absence of a supporting analysis, the justification for accepting the cost and risk premium of up to \$1 million by not tendering, and the deeming of benefits of \$2.4 million, were questionable.

Department's response: In this particular case, a reasonable final price for the project was obtained. The Department ensured local benefits for the First Nation through a flexible approach to the tendering process. This approach enabled the First Nation to participate in a joint venture on components of the project, which, in turn, supported capacity development at the local level.

The Department ensured that value for money was obtained by negotiating with the First Nation an upper limit for the project costs and requiring that the subcontracts (approximately 70 percent of the total project cost) were publicly tendered. The remaining 30 percent of the work was negotiated as local set asides using standard industry rates in the area to ensure that a fair and reasonable price was obtained. The final costs for the project are comparable with the cost estimated for a public tendered contract including a local preference allowance.

The Department has established a requirement for First Nations to use a tendering process for capital projects over \$500,000, excluding housing, and it recognizes the need to work with First Nations to implement this policy. As recognized by the Auditor General, the Department is faced with the challenge of achieving a balance between the concepts of achieving best value for federal funds and increased socio-economic benefits for First Nations. The Department is working on a paper to define general principles for guiding First Nations tendering policies.

Industry Canada

Assistant Auditor General: Richard Flageole
Responsible Auditor: Peter Simeoni

Concerns over accountability requirements for \$801 million payment

The government made a payment of \$801 million to the Canada Foundation for Innovation. The funding agreement does not obligate the Foundation to report on the results it achieves with this money. In our view, it is important that any future funding agreements with similar organizations provide for a full annual report on performance to Parliament.

Background

36.48 Parliament established the Canada Foundation for Innovation through the *Budget Implementation Act, 1997* as an independent, not-for-profit corporation whose purpose is to make grants “to increase the capability of carrying on high-quality research in Canada.” The Foundation is made up of 15 members, representing the research and business communities, and is managed by a separate board of directors. The Act authorized the Minister of Industry to pay up to \$800 million plus interest to the Foundation.

36.49 The Minister and the Foundation reached a funding agreement in July 1997. Its purpose was to set out the terms and conditions under which the Foundation would administer and invest the payment from the government and would determine which projects to fund. The agreement requires the Foundation to endeavour to commit the \$801 million and any investment proceeds (an estimated \$100 million) to projects within five years. The Foundation will use the money to support the modernization, acquisition or development of research infrastructure such as equipment, software, buildings and other facilities by making grants of up to 50 percent of the total cost of eligible projects. The agreement also defines eligible recipients, projects and costs as well as setting out submission requirements and factors the Foundation must consider in reviewing applications. The provisions are intended to help ensure that the Foundation funds projects that meet the agreement’s objectives.

36.50 In announcing the creation of the Foundation, the government stated:

The Foundation represents an entirely new approach by the government to supporting innovation and research. It will be an independent corporation, at arm’s length from the government, and its members will be drawn from the research community and the private sector. They, not the government, will be responsible for spending decisions.

36.51 We examined the government’s funding agreement with the Foundation to determine whether it provided for good accountability to Parliament for the \$801 million payment. In our view, good accountability begins with the government clearly describing its goals and planned actions and ends with a full accounting to Parliament for the results achieved. Reporting obligations need to be clearly set out and cover both financial and operational results when the government enters into “arm’s length” arrangements or into partnerships to achieve these goals.

Issues

No obligation to report on results achieved with \$801 million

36.52 The Act requires the Foundation to prepare an annual report of its activities, including audited financial statements, which the Minister of Industry tables in Parliament. We expected that the funding agreement would elaborate on this general requirement to provide for good accountability to Parliament for the \$801 million payment by obligating the Foundation to report not only on its activities but also on its performance more broadly — in other words, on the results it achieved with the grants it made. While we recognize that the Foundation is independent, the annual performance reports of the government’s granting councils for science illustrate at least the kind of reporting that is possible. In particular, these annual reports are supposed to present results achieved by the councils through their granting activities. However, the funding agreement with the Foundation contains no such provision. While it appears that the Foundation will nonetheless make every effort to give a good annual account of its achievements toward its objectives, our concern is that the government did not obligate it to do so. In our view, any future funding agreements with similar organizations should unambiguously require that a full, annual accounting for performance be made to Parliament, and that this report be audited. This is particularly important as the government provides more goods and services through partnerships with organizations outside the traditional public service, and therefore outside established performance reporting systems.

36.53 Although the funding agreement does not provide for it, program evaluation is an important part of performance measurement and reporting. There is, of course, nothing preventing the Foundation from having an evaluation carried out and reporting the results to Parliament. In our view, future funding agreements such as this should have an evaluation requirement so that Parliament is informed of what was accomplished with the funding provided.

Conclusion

36.54 The government made a payment of \$801 million to the Canada Foundation for Innovation. The funding agreement does not obligate the Foundation to report on the results it achieves with this money. In our view, it is important that any future funding agreements with similar organizations provide for a full annual report on performance to Parliament.

***Department’s response:** The funding agreement addresses the accountability issue by setting out appropriate terms and conditions on the use of the \$801 million by the Foundation. Specifically, the agreement sets out: four specific objectives that will guide the Foundation in all of its activities and decisions; extensive provisions with respect to the specific project costs that are eligible and excluded, for purposes of cost-sharing with the Foundation; a requirement that applicants must provide a research plan that contains specified information, as well as other information; mandatory criteria that all successful applicants must meet, as well as criteria to be used when assessing proposals; the requirement to establish a peer review system to assess research plans; and how in-kind contributions are to be treated. Taken together, these provisions will be critical in ensuring that those infrastructure projects funded by the Foundation will be of the highest quality, with the highest socio-economic potential.*

The Foundation is working to develop a framework to evaluate the results of its grants for research infrastructure. Of course, one has to bear in mind that the research projects will take time to come to fruition and have an impact on the economy and society. The establishment of the Foundation as an arm’s length organization represents an original and unique approach to supporting innovation in Canada. A highly qualified Board of Directors with diverse expertise, experience and perspective is being put in place that, we are confident, will meet the challenge of maximizing the benefits flowing from the Foundation and meet the innovation needs of Canada.

National Archives of Canada and Public Works and Government Services Canada

Assistant Auditor General: Shahid Minto

Responsible Auditor: Reno Cyr

The design and construction of the National Archives of Canada's Gatineau Preservation Centre could have been achieved in a less costly building. The facility illustrates a "build [up] to budget" approach that does not encourage cost savings

Design and construction of the Gatineau facility has been achieved at a higher unit cost than a similar-purpose U.S. facility. The design requirements imposed by the selected site, and the creation of this striking facility in response to the National Archives' objective to create a facility with the image of a leading archival centre having a national heritage and cultural element, have contributed to the higher cost.

During construction of the Gatineau Preservation Centre and subsequent to our 1994 audit, the elimination of \$10 million in unnecessary extras in the design, finish and landscaping was required to meet budget targets. The reduction was achieved without unduly compromising program requirements.

In our opinion, the storage, preservation and active conservation functions, which exclude any significant access to the facility by the public, could have been accommodated in a less expensive building. The fact that significant cuts were achieved but that additional cost-saving opportunities were not exercised illustrates the lack of cost-saving incentives under the government's "build [up] to budget" approach.

Background

36.55 As part of a composite project to respond to the needs of the National Archives of Canada, including the need to arrest the deterioration of records in existing storage facilities, a new conservation and laboratory building was constructed in the city centre of Gatineau, Quebec, at a total project cost of \$107 million. The second part of the composite project was to renovate the West Memorial Building to create public research facilities and replace those currently provided in the National Library building, and to refurbish the National Archives headquarters. The second project was approved in May 1996 and is expected to be completed by 2002.

36.56 The new Gatineau facility provides for the consolidation of storage and laboratories from several facilities and allows for further consolidation and future growth of the archival records. The facility has been designed to provide a safe environment for the long-term storage and active preservation of the country's valuable collections.

36.57 In 1994 we examined the preliminary stages of construction of the new Gatineau facility and concluded, in part, that there was a lack of due regard to economy in the site selection and related design, finish and landscaping considerations for the facility.

36.58 In 1995 we undertook a joint study with National Archives of Canada and Public Works and Government Services Canada to compare the cost of the new Gatineau facility with a similar-purpose U.S. facility.

36.59 In 1996 we reported on the government's "build [up] to budget" philosophy in our audit of a large government-owned special purpose facility. Under this approach, certain aesthetic enhancements to the facility were included on the basis that the budget would not be exceeded. In its published response, the Treasury Board Secretariat acknowledged the need to place greater emphasis on cost savings within the overall approved budget.

36.60 The new Gatineau facility, now referred to as the National Archives of Canada Gatineau Preservation Centre, was made available for occupancy in December 1996, and was officially opened on 4 June 1997. The relocation of records into the new vaults of Phase I of the Gatineau facility is ongoing and expected to be completed by March 1998. A Phase II project is planned in Gatineau for some time in the future to provide for further consolidation and growth of the collections.

Issues

36.61 Gatineau facility is more expensive than a similar-purpose U.S. facility. At the time of reporting our 1994 audit, agreement could not be reached with National Archives of Canada and Public Works and Government Services Canada on the appropriate costs to include in comparing the Gatineau facility with the recently completed United States National Archives and Records Administration (NARA) II facility in College Park, Maryland. It was agreed that a joint study would be undertaken to confirm and explain the cost differences. The study findings, agreed to by the joint participants and reported to the deputy heads in October 1995, are summarized in this section.

36.62 The three major cost elements of both projects, representing approximately 80 percent of the total project costs, include construction (contracts and material), architectural and engineering services (A & ES) management, and professional services. Architectural and engineering services management includes design reviews, preparation and review of documents, commissioning, administration and auditing. Professional services cover such things as architectural fees, special consultants and taxes.

36.63 The findings of the cost study, which support the preliminary conclusions of our 1994 audit, are summarized in Exhibit 36.1. Comparison of the individual project cost elements for the two facilities, on a unit-cost basis, shows a cost difference of 29 to 66 percent. The construction management activity, represented by combining the individual elements of A & ES and professional services, account for a 58 percent difference. In all cases, the percentage differences reflect the lower cost of the U.S. facility.

Exhibit 36.1

Summary of Cost Comparisons

Project Cost Element	Gatineau Facility (32,500 sq m)	NARA II Facility (170,900 sq m)	Unit Cost % Difference
	\$(000)	\$(000)	
Construction	72,639	270,125	29
A & ES Management	5,425	15,796	45
Professional Services	8,081	14,323	66
Total A & ES Management & Professional Services	13,506	30,119	58

36.64 Due to the differences in size of the facilities, the comparison uses the industry standard approach of comparing costs per square metre of building gross area in arriving at the percent differences. Construction unit costs, based on industry standards for measuring gross area, were calculated after deleting some components from the NARA II facility to achieve a more accurate comparison of constructed features.

36.65 It should be noted, however, that the study also indicated that comparisons between unique special purpose buildings are difficult and will not give a definitive answer. The factors that limited the opportunity for comparison of the projects included funding mechanisms, design life cycles, building area and location, user programs, and contracting and implementation policies. These limitations notwithstanding, the study identified several factors that contributed to the higher cost of the Gatineau facility, as follows:

- **The method of funding.** Because the funding for the NARA II facility was received as a lump sum, the project benefited from the ability to tender contracts when the timing in the construction industry was opportune.
- **The management of tendering and contracting.** NARA had final contracting authority and did not have to seek additional approvals for each contract. This authority shortened the tendering period and encouraged the use of more and smaller tender packages.
- **Site selection.** The design of the Gatineau facility was significantly influenced by its urban and highly visible site. The design of the NARA II facility was not influenced to this extent by its siting.
- **Fees.** Consultant fees and management and supervision fees were higher on the Gatineau project. There were extra layers of management, due in part to the number of parties involved and the division of their roles.
- **Incentives for cost savings.** There were incentives for NARA to achieve cost savings on its construction project, but no such incentives for National Archives on its project. Since NARA had complete control of its construction budget and would have had to fund any shortfalls from its operating budget, there was pressure to control costs. As an added incentive, cost savings on construction could be and were used to purchase furniture and equipment and to upgrade some key systems. For the Gatineau facility, any cost savings from construction would not accrue to the client but rather to Public Works and Government Services Canada, the contracting agent.

36.66 “Build [up] to budget” approach does not encourage cost savings. In 1994 we noted that funds were being spent on site and design considerations that exceeded the functional needs of the building. In granting preliminary project approval, Treasury Board ministers expressed the view that design and consequent costs of the Gatineau facility should place emphasis on functional requirements. We concluded that the siting of the facility and concerns with public visibility resulted in a design that emphasized factors other than the functional requirements. For example, the intent of the client’s general design, as conveyed to the architect, emphasized that “the Gatineau Building will present the image of a leading archival centre, a National heritage and cultural element”, despite the absence of plans for any significant access to the facility by the public and a mandate to stress functionality.

36.67 Since 1994, a review of the project budget and contract requirements was necessitated when the low bid for the major construction contract came in approximately \$10 million over budget. The review concluded that significant cost savings were possible without unduly compromising program requirements. Revisions were then made to the design and materials to meet the budget. We believe that this illustrates the need for a more rigorous and meaningful analysis of project requirements before a budget is approved.

36.68 The government’s project approval and project management policies provide incentives not to exceed approved budgets, but there is little incentive to bring projects in under budget, even where significant excesses exist. In this project, the elimination of \$10 million of unnecessary extras, of which a significant portion represents the cost of stainless steel, would not have occurred had the low bid not exceeded the contract budget. However, notwithstanding the cuts already made, the completed facility retains large quantities of costly stainless steel in the superstructure. These facts raise serious questions about whether further cost savings could have been achieved without compromising program requirements.

36.69 Commitment to emphasize functional requirements with simple and proven approaches not met. In 1994 we identified design features that were not consistent with the commitment made to the Treasury Board to emphasize functional requirements using simple and proven approaches. In its published response, Public Works and Government Services Canada noted that the design and construction were appropriate for a utilitarian building. In our opinion, however, the following examples illustrate that key elements of this project were neither utilitarian nor simple and proven.

36.70 The original stainless steel roof was subsequently redesigned using a less costly material as part of the cost-cutting measures. However, the composition and assembly of the new design were unproven and complex, because no company had ever constructed such a roof and because of its unique layered construction and assembly requirements.

36.71 The “building within a building” design of the Gatineau facility incorporates a concrete structure enclosed by an outer shell consisting of a hanging glass curtain wall and a stainless steel superstructure, as discussed earlier. The glass curtain wall comprises a size of glazing that restricted the number of potential suppliers and has resulted in problems with specifications, quality control in the manufacture and installation to meet industry standards, and the degradation of thermal properties of the curtain wall.

36.72 A simpler and less costly exterior finish such as brick, pre-cast concrete or porcelain enamel steel would have avoided these difficulties.

36.73 Extensive landscaping plans scaled back. In 1994 we noted that plans included extensive landscaping to create a park-like setting and to mitigate the imposing nature of the building. There was also a desire to ensure that the building did not look like a warehouse, given its siting within the Gatineau city centre and its proximity to a residential neighbourhood.

36.74 We are encouraged to report that, since 1994, changes have been made to the landscaping design that have considerably reduced the extent of work done while attempting to maintain the original landscaping objectives. The changes were partly in response to our concerns about the magnitude and functionality of this cost element and partly in response to the need to cut \$10 million to meet the project budget.

36.75 In our opinion, however, the original landscaping plans, like the original stainless steel roof, were based on the availability of funding in the project budget, and reduction of the landscaping would not have occurred had there not existed budget or other external pressures to do so.

Conclusion

36.76 The National Archives’ design objective for the new Gatineau facility has been achieved. The impressive facility makes a striking architectural statement and has received significant positive public attention. The stated objective of creating a facility that provides a safe and secure environment for the long-term storage and ongoing preservation of the country’s historic treasures has also been achieved.

36.77 Although not all costs have been finalized, it now appears that the budget targets have been achieved and that National Archives of Canada is satisfied that its program requirements have not been significantly compromised as a result of the cost reductions. However, in our opinion, the storage, preservation and active conservation functions, which exclude any significant access to the facility by the public, could have been accommodated in a less expensive building.

36.78 The project approval and budgeting processes set out in the Treasury Board policies for managing capital projects of this magnitude require departments to examine their needs, analyze options available to meet those needs, prepare cost estimates and seek Treasury Board approvals and any adjustments to departmental reference levels to meet the capital or operating and maintenance costs of the new facility.

36.79 One key element of this process is that the project budget be subjected to a rigorous and meaningful analysis to ensure that it is sufficient but not excessive in supporting the project objectives. In the case of the new Gatineau facility, however, the approved budget exceeded that needed to address the functional requirements of this building, as outlined in the National Archives’ project submission and the resulting Treasury Board approvals. The

result was a “build [up] to budget” approach that included costly aesthetic elements in the design. It has been recognized that many such projects are built to budget, and that there is a need to change this culture. We would have expected a more rigorous challenge of the design and associated budget by the departments and by the Treasury Board Secretariat.

36.80 In its Eighteenth Report to Parliament in December 1995, the Public Accounts Committee noted that there is more to being a good officeholder than simply following the rules. It maintained that those who hold public office are also obliged to show regard for the interests of citizens and to protect those interests to the fullest possible extent. In our opinion, the interests of the taxpayer would have been better served by constructing a facility that responded more to the mandate to emphasize functional requirements related to safeguarding and preserving the historic records and less to creating an architectural statement of national significance.

***Department’s response:** The National Archives of Canada - Gatineau Preservation Centre (GPC) project was delivered on time and on budget and fully meets the expectations of all affected parties including the National Archives of Canada, Heritage Canada, the National Capital Commission and the Municipality of Gatineau. Within the project investment and management context of the early 1990s, Public Works and Government Services Canada (PWGSC) delivered a project that met established standards for success (scope, functionality, time, budget) for a project that has been recognized as an “impressive facility” that has received “significant positive comment”. However, PWGSC recognizes the concerns raised by the Office of the Auditor General regarding the “build to budget” approach, and is currently working to identify ways to introduce, into the overall contracting process, viable and meaningful incentives for reducing costs.*

PWGSC also concurs with the observation that a definitive cost comparison between unique special purpose buildings such as the American NARA II facility and the GPC is difficult.

The location of the GPC is a major element of the cost differential. The criteria governing the site selection and development of the GPC warranted investments that contributed significantly to project costs. Unlike the facility in the United States, the GPC is a significant landmark in the town centre of a major Outouais community within the National Capital Region. PWGSC therefore concurs with the Office of the Auditor General that the facility has met its objective “to present an image of a leading archival centre, a national heritage and cultural element.” PWGSC believes that the broader government objectives affecting the qualitative aspects of investment considerations must be incorporated into the assessment of the project. PWGSC recognizes that these value-for-money considerations as well as related constraints should be specifically articulated within project approval documentation. PWGSC will reaffirm internal policies accordingly and ensure that future projects explicitly reference such considerations where applicable.

Revenue Canada

Assistant Auditor General: Shahid Minto
Responsible Auditor: Alan Gilmore

Revenue Canada departed from departmental standards and practices in awarding a duty free shop licence

Since 1985 Revenue Canada has maintained rigorous standards and practices for the award of duty free shop licences at land border crossings to individuals or corporations. The standards and practices followed by Revenue Canada in the 1995 and 1997 award of a duty free shop licence at one land border crossing differed significantly from those normally used. The precedents set may undermine the transparency and credibility of the duty free shop licence award process. There are conflicting interpretations of a section of the Regulations relating to beneficial ownership. In our opinion, a reasonable case can be made that the awarding of the licences was not done in accordance with the intent of the law.

Background

36.81 Revenue Canada is responsible for issuing licences for the operation of duty free shops and for monitoring and controlling their ongoing operation. In 1995, Revenue Canada awarded a duty free shop licence in Ontario to an individual at a major land border crossing where there had been a demand for such a shop. Revenue Canada estimated that gross revenue to the duty free shop operator at the site would be approximately \$13.5 million dollars annually. In September 1997, subsequent to the death of the licensee, a new duty free shop licence was awarded to a corporation.

36.82 Since 1985, Revenue Canada has maintained rigorous standards and practices that must be followed in the award of licences to individuals or corporations. These standards and practices are described in the following documents: *Customs Act*, Duty Free Shop — Regulations; Duty Free Shop — Licensing (Guidelines); the Applicant's Guide and Application; and, in Ontario, the Memorandum of Understanding between Revenue Canada and the Ontario Ministry of Consumer and Commercial Relations and the Liquor Control Board of Ontario.

36.83 The Regulations and Guidelines require that all applicants meet the following prerequisites before their application is considered. To be eligible, under the Regulations, to operate a licensed facility at a land border crossing, applicants must be Canadian citizens or permanent residents of Canada. A corporation can be considered for a licence at a border crossing if it is incorporated in Canada and all shares are beneficially owned by Canadian citizens or permanent residents of Canada. The Guidelines state that an applicant must qualify as a small-size business or, in exceptional circumstances, as a medium-size business in Canada to be considered to operate a land border crossing duty free shop.

36.84 Applicants who meet these qualifications may submit an application for a licence for the operation of a duty free shop. Revenue Canada selects the successful applicant on the basis of an evaluation and ranking of the individual proposals, which must provide detailed information in seven areas. These include the qualifications of the beneficial owners, the applicant's financial stability, financial statements presenting detailed three-year forecasts of operational performance, a description of the applicant's management capabilities and retail experience, site and building proposals, a comprehensive business plan, and employment policy.

36.85 No fee is paid to Revenue Canada for the issuance of a duty free shop licence; however, a shop pays Revenue Canada a licence fee based on

a percentage of its annual gross revenue. Once a duty free shop licence is awarded, the operator retains the rights to the licence indefinitely unless proven to be in breach of the Duty Free Shop Regulations.

Issues

36.86 In 1995 and 1997, Revenue Canada awarded a duty free shop licence at the same land border crossing in Ontario. We found that the standards and practices used in the award of these duty free shop licences in Ontario differed significantly from those used in other land border crossing licence awards.

36.87 In awarding the licences in 1995 and 1997, Revenue Canada departed from its standard duty free shop licence award practices at land border crossings. The information on which Revenue Canada made the award was incomplete and did not address key areas such as business competence and operating practices.

36.88 Furthermore, in our opinion, the awards were not consistent with the intent of the Duty Free Shop Regulations' requirement that the ultimate beneficial ownership of a shop rest with Canadian citizens or permanent residents. In both instances, Revenue Canada documentation indicates that the ultimate beneficial ownership rests with a third party that does not qualify to operate a duty free shop because it is a foreign entity.

36.89 Revenue Canada explained to us that the circumstances in these awards were unique because the owner of the land at this border crossing refused to lease property for a duty free shop to anyone other than the landowner's nominee for the shop. The owner of the land is a foreign-owned Canadian corporation.

36.90 Revenue Canada also stated that both licences were awarded in accordance with the law. In our opinion, an equally reasonable case could be made that the licences were not awarded in accordance with the law. This is a matter that only a court could decide conclusively.

36.91 Revenue Canada indicated to us that it was faced with a difficult situation. Officials were anxious to fulfil a public need while dealing with a landowner who insisted on his nominee and at the same time complying with Revenue Canada Regulations and Guidelines that provided the officials with limited options.

36.92 **In contrast with standard practice, there was no national tender call in the award of these duty free shop licences.** For all other licence awards since 1985, Revenue Canada has placed a national advertisement inviting applications for the establishment and operation of a land border crossing duty free shop. The applications are reviewed by Revenue Canada staff, a professional accounting firm, and a Selection Advisory Committee. In Ontario, this committee consists of representatives from Revenue Canada, Industry Canada and the Liquor Control Board of Ontario. The granting of a liquor Authorization by the Liquor Control Board is usually made concurrently with the duty free shop licence award.

36.93 The awarding of these two licences to operate the duty free shop was non-competitive. All licence awards at other land border crossings were competitively bid. The opportunity to secure a licence at this facility was not made known to the public, even though a number of individuals had expressed a strong interest to Revenue Canada in operating a facility at this site. Further, Revenue Canada did not provide complete and accurate information to some of these individuals on the availability of a licence at this site. In our opinion, these actions were inconsistent with historical practice, the standards defined in the Duty Free Shop — Licensing Guidelines, the Applicant's Guide and the Memorandum of Understanding.

36.94 Revenue Canada proceeded with the award of the licences without the agreement of the Province of Ontario as required by a June 1985 Memorandum of Understanding among Revenue Canada, the Ontario Ministry of Consumer and Commercial Relations, and the Liquor Control Board of Ontario. The Memorandum also requires Revenue Canada to "invite applications by national advertisement for the establishment and operation of duty free

shops” and to consult and reach a consensus on the selected operator with the Province prior to the award of licences in Ontario.

36.95 The licence awards are not consistent with the intent of the Duty Free Shop Regulations and Guidelines that beneficial owners be Canadian citizens or permanent residents. In our opinion, the intent of the Duty Free Shop Regulations and Guidelines is to require that all direct or indirect beneficial ownership interest in a duty free shop at a land border crossing be held by individuals who are Canadian citizens or permanent residents. A Canadian corporation may also be awarded a licence if all its shares are beneficially owned by Canadian citizens or permanent residents. The Guidelines state that the “applicant must qualify as a small–size business” or, in exceptional circumstances, as a medium–size business.

36.96 Revenue Canada states that since only the holders of a licence for a land duty free shop need to be Canadian citizens, the issue of beneficial ownership is simply not in question. We disagree with this interpretation since this presents a very restricted view of the intent of the Regulations. The licence awards at this site are not consistent with the substance of the above–noted requirements. In 1995 the licence was awarded to a Canadian citizen. However, this individual was serving as a nominee for third parties who do not qualify to be awarded a duty free shop licence. Revenue Canada documentation indicates that the ultimate beneficial ownership of the licence appears to rest with a foreign entity. While a Canadian corporation is managing and operating the duty free shop on behalf of the nominee, the corporation does not qualify as a small or medium–size business and, further, it is foreign–owned.

36.97 In 1997, the licence was awarded to a Canadian corporation for the 34 months remaining in the 1995 licence. Revenue Canada documentation indicates that the award was made because “many of the circumstances will remain unchanged with respect to this duty free shop operation, the Department believes this would recognize commitments and interests that were made in good faith by the parties involved.”

36.98 The corporation shareholders have indicated to Revenue Canada that they are the “true beneficial shareholders”. However, in our opinion, Revenue Canada did not obtain sufficient documentation to determine and verify that the shareholders are the true beneficiaries of the licence — that is, whether they are the effective owners with all the benefits and responsibilities associated with ownership as opposed to a situation where the owners function merely as intermediaries. The 1997 licence award was made subsequent to our raising with Revenue Canada our concerns about the 1995 award.

36.99 Revenue Canada did not have sufficient information to ascertain whether the applicants met the qualifications to operate a duty free shop at a land border crossing. The normal practice in the process for awarding duty free shop licences at a land border crossing is for all agreements, including commercial agreements and information on duty free shop ownership and operation, to be examined by Revenue Canada. The object of the examination is to ascertain whether the applicant is in compliance with the Regulations and Guidelines, and particularly whether the applicant is qualified to operate a duty free shop.

36.100 For the 1995 and 1997 awards, the agreements between the Canadian nominee and the foreign–owned companies relating to ownership structure and the financial, retailing and operating plans for the duty free shop were not fully disclosed to Revenue Canada as required by the Duty Free Shop Licensing Guidelines. The Department states that since a tendering process was not deemed appropriate, information normally required as part of a competitive tendering process was not obtained.

36.101 Revenue Canada documentation for the 1995 licence indicates that the foreign–owned companies entered into a number of agreements. For instance, one established a Canadian–based representative (nominee) who, in return for certain benefits, would hold the licence on their behalf; another involved a contract between the nominee and one of these foreign–owned firms to manage and operate the duty free shop.

36.102 The foreign-owned Canadian company requested that it not be required to disclose its private commercial information, including its agreements. Revenue Canada agreed to this request and thus could not make a fully informed assessment of whether the applicant for the 1995 licence was qualified. For the 1997 licence, similar information was not disclosed to Revenue Canada.

36.103 The 1995 and the 1997 application also did not address whether the applicants met the key business competence requirements of the Duty Free Shop — Licensing Guidelines and Applicant’s Guide. For example, for both the 1995 and 1997 award, the applicant’s submissions did not contain a comprehensive business plan or information on the applicant’s management capabilities and retail experience. This incomplete application information was accepted by Revenue Canada.

36.104 Revenue Canada informed us that it had deviated from normal licence award practices due to the unique circumstances at this site. Revenue Canada documentation indicates that the foreign-owned Canadian corporation, the owner of the land at the border crossing, refused to lease property for a duty free shop to anyone other than its nominee. This position was accepted by Revenue Canada officials who were anxious to fulfil a public need for a duty free shop at this crossing.

36.105 Conflicting interpretations of the Regulations raise concerns about the intent of the law. Revenue Canada informed us that the 1995 and 1997 licences were awarded in accordance with the Duty Free Shop Regulations. We examined this representation. The relevant sections of the Regulations state:

3.(3) A corporation is qualified to operate a duty free shop at a border crossing point if

(a) the corporation is incorporated in Canada; and

(b) all the shares of the corporation are beneficially owned by Canadian citizens or permanent residents...

3.(4) A person other than a corporation is qualified to operate a duty free shop at a border crossing point if the person

(a) is a Canadian citizen or permanent resident...

36.106 The 1995 licence was awarded to an individual. The position of Revenue Canada that the 1995 award was made in accordance with the law would be correct if the Duty Free Shop Regulations were read strictly and literally, in particular, sub-section 3(4), which does not expressly stipulate that a person who is licensed needs be the beneficial owner of the duty free shop. However, if one were to take the position that the Regulations must be given an interpretation that would best ensure the attainment of the objectives of the Regulations, then, in our opinion, an equally reasonable case could be made that the granting of the 1995 licence was not in accordance with the law. This interpretation would be supported by the interpretation given the Regulations in Revenue Canada’s Guidelines for licensing duty free shops at land border crossings. However, only a court could resolve these legal issues conclusively.

36.107 As indicated, in September 1997, a new licence was awarded to a Canadian corporation. Paragraph 3.(3)(b) of the Regulations requires that the beneficial owners of the duty free shop be Canadian citizens or permanent residents. The Canadian shareholders of the corporation wrote to Revenue Canada stating that they are the “true beneficial owners”. However, Revenue Canada did not verify this representation. If the beneficial ownership actually rests with a foreign entity, as we think may well be the case, then, in our opinion, the licence award was not made in accordance with the law.

Conclusion

36.108 The duty free shop program may have been adversely affected by the precedents set by these licence awards. In awarding the licences discussed above, Revenue Canada did not, for reasons explained earlier, follow certain of its standards and practices for awarding duty free shop licences.

36.109 We are concerned that other individuals, corporations or government agencies who have property ownership or jurisdictional control at land border crossings may now similarly demand that duty free shop licences be awarded to designated individuals of their choice without a competitive process and without disclosure of their ownership and operating agreements. More important, we are concerned that the manner in which these duty free shop licences were awarded may undermine the transparency and credibility of the duty free shop licence award process.

Department's response: It is the position of the Department that the applicants for the licences in question satisfied all of the requirements under the law and regulations as they pertain to the operation of duty free shops at land border crossings. Moreover, it is our position that the decision to award the licences without recourse to an open tendering process was in full conformity with the law, reflected appropriate judgment in light of the unique circumstances of this case, and in no manner compromised the integrity of the duty free shop program.

The applicants for the duty free shop licences submitted documentation demonstrating that they met all of the requirements set out in section 3.0 of the Duty Free Shop Regulations, including the principal requirement that beneficial ownership of the shares of any corporation applying for a duty free shop be held by individuals who are Canadian citizens or permanent residents. This documentation was reviewed thoroughly by departmental officials, in consultation with lawyers from the Department of Justice, and was found to satisfy all of the regulatory requirements. Information normally required as part of a competitive tendering process was neither requested nor required, as a tendering process was not undertaken in this case.

With regard to the Department's decision not to award the licences through a competitive process, it should be noted that there is no statutory or regulatory requirement that a licence for a duty free shop be awarded through a tendering process. Moreover, the case at hand is unique and without precedent. It is the first occasion that the Department has been formally approached by a private interest and asked to award a duty free shop licence to a specific, qualified applicant. Indeed, the owners of the land upon which the duty free shop was to be located stated categorically that they would only provide a lease to their nominee. This being the case, once the nominee was considered to be qualified according to the Regulations, a tendering process was not a viable option. It would not have been in the public's best interest as the outcome was a foregone conclusion.

However, the concerns raised by the Auditor General with respect to the transparency and credibility of the duty free shop licence award process have been duly noted. As a consequence, upon the expiration of the current licence, the Department intends to award any future duty free shop licence at that site through an open, competitive process, notwithstanding any position the owners of the land may take in advance.

It is the Department's position that the decisions and actions of its officials were entirely in accordance with the law and do not constitute a precedent that would adversely affect the administration of the duty free shop program. Departmental officials exercised prudent judgment in administering the law and regulations in a fair, equitable and impartial manner. There is no evidence to suggest that the actions of our officials jeopardized the integrity of the duty free shop program or were precedent-setting.

Finally, in light of the issues raised by the Auditor General with respect to conflicting interpretations of the regulations and the intent of the law, the Department has undertaken to pursue a full review of the Duty Free Shop Regulations, in concert with the Department of Finance, commencing in January 1998.

Chapter 37

Sustainable Development Strategy for the Office of the Auditor General

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Sustainable Development Strategy for the Office of the Auditor General

Deputy Auditor General: Michael J. McLaughlin

Responsible Auditor: Gisèle Grandbois

Main Points

37.1 This is the Office of the Auditor General's (OAG) first sustainable development strategy. It tells parliamentarians how we intend to integrate environmental and sustainable development considerations into our business as a legislative audit office, and how we will measure our success in doing so.

37.2 This Office has a long history of involvement in environmental and sustainable development issues. In particular, over the past decade it has been a leader in conducting audits related to the environment. The *Auditor General Act* was amended in December 1995 to formally incorporate environmental and sustainable development issues into our mandate. The Commissioner of the Environment and Sustainable Development was appointed by the Auditor General in 1996.

37.3 Our sustainable development strategy encompasses the three core dimensions of our activities: our audit operations, our day-to-day operations, and our human resources. The sustainable development goals for our audit work are to promote sustainable development by:

- providing advice and information to parliamentarians and members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work;
- supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations;
- providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada.

37.4 Another goal we have is to minimize the negative environmental impacts of our day-to-day operations. Finally, we wish to support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals.

37.5 Our strategy is action- and results-oriented: for each of our sustainable development objectives, we have identified the specific actions we need to take and have developed performance indicators that will help us monitor our progress toward achieving our goals and objectives.

37.6 The most pressing environmental and sustainable development issues facing government today cut across departmental mandates and political jurisdictions. Auditing these horizontal and cross-jurisdictional issues represents a challenge of integration and co-ordination for our audit teams as well as an opportunity to broaden our perspective.

37.7 Departmental sustainable development strategies represent a very important new tool for federal organizations. In addition to monitoring their progress, we will help strengthen the capacity of these organizations to build better strategies and implement them. Similarly, the petition process will create a more direct link with Canadian citizens wishing to express their concerns about the environment and sustainable development.

37.8 Globally, we believe we can make a difference in the quality of Canada’s environment, and in its prospects for sustainable development.

Exhibit 37.1 Sustainable Development Goals and Objectives and Key Performance Indicators for the OAG

Sustainable Development Goals	Sustainable Development Objectives	Key Performance Indicators
<p>OUR AUDIT WORK: To promote sustainable development by:</p> <ul style="list-style-type: none"> • providing advice and information to parliamentarians and members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work; • supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations; • providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada 	<ul style="list-style-type: none"> • To incorporate environment and sustainable development as an integral part of our audit work • To monitor the extent to which federal and territorial organizations have met the objectives and implemented the action plans set out in their sustainable development strategies • To help strengthen the capacity of federal organizations to manage environmental and sustainable development issues • To monitor the replies by departments to petitions made by Canadians about environmental and sustainable development concerns 	<ul style="list-style-type: none"> • % of parliamentarians who feel that our work has helped them - who better understand sustainable development issues and who use our chapters • % of OAG references in the House of Commons and the Senate that were about environmental and sustainable development issues • Number of federal organizations that improved their environmental and sustainable development reporting and performance • % of our recommendations related to environment and sustainable development on which satisfactory progress was made
<p>OUR ADMINISTRATIVE ACTIVITIES: To optimize the use of natural resources and to minimize the negative environmental impacts of the OAG’s day-to-day operations</p>	<ul style="list-style-type: none"> • To complete and implement our Environmental Management System (EMS) • To reduce paper and paper product consumption • To increase the “greenness” of our purchases • To reduce energy and water consumption • To maximize the capture of recyclable material / To reduce waste production • To encourage the use of environmentally responsible transportation for our audit work whenever it is time-efficient / To encourage the use of teleconferencing 	<ul style="list-style-type: none"> • Quantity of paper consumed per employee per year • % of products stocked that are Ecologo products
<p>OUR HUMAN RESOURCES: To support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals</p>	<ul style="list-style-type: none"> • To enhance the capacity of OAG staff to recognize and integrate sustainable development related issues into their audit work • To increase OAG staff awareness and practice of sustainable development efforts in the Office’s day-to-day operations and society at large 	<ul style="list-style-type: none"> • Self-assessment of staff ability to recognize sustainable development-related audit issues • % of staff who participated in sustainable development training sessions

Why a Sustainable Development Strategy for This Office?

What do we mean by sustainable development?

37.9 By sustainable development, we mean “development that meets the needs of the present without compromising the ability of future generations to meet their needs.” (World Commission on Environment and Development, *Our Common Future*, 1987)

37.10 Sustainable development is a constantly evolving concept based on the integration of social, economic and environmental concerns into the activities of private or public organizations.

37.11 Progress toward sustainable development requires an integrated approach to planning and decision making that involves evaluating economic and social solutions on the basis of their effects on the environment and natural resources, and ecological solutions on the basis of their effects on the economy and society.

The Auditor General Act and A Guide to Green Government

37.12 Following the amendments made to the *Auditor General Act* in December 1995, 24 federal departments and agencies are required to table sustainable development strategies in the House of Commons by 15 December 1997. The amendments to the Act also call for the Commissioner of the Environment and Sustainable Development, who was appointed by the Auditor General in 1996, to review the departmental strategies. *A Guide to Green Government*, which was published at the time the amendments were made, presents key elements that departments should consider when preparing their strategies and suggests a way to develop and structure them.

37.13 This Office is not among the 24 federal organizations required to prepare a sustainable development strategy. However, given that sustainable development strategies are an extremely valuable planning tool for nearly all private or public organizations, we have decided to develop our own strategy and to table it in the House of Commons before 15 December 1997.

What our sustainable development strategy is ...

37.14 Our sustainable development strategy is designed to be comprehensive, results-oriented and developed through consultation:

- **comprehensive** because it covers the environmental and sustainable development aspects of our audit work and our day-to-day operations;
- **results-oriented** because we have identified the actions we need to take and the indicators we will use to judge performance toward each of our sustainable development objectives;
- developed through **consultation** because we have conducted an extensive communication and consultation campaign within the Office and with all our clients. These different points of view were extremely useful to us (see appendices A and B).

37.15 Sustainable development is not a new concept for the Office. We have been taking environmental and sustainable development issues into account in our audits for more than 10 years. Similarly, the environment and sustainable development are one of the Office’s five priorities for 1996–2001. Creating the position of the

Commissioner of the Environment and Sustainable Development and establishing his team in 1996 confirms the importance that Parliament and the Office attach to these issues.

... and what it is not

37.16 Our sustainable development strategy is not a substitute for the regular selection process for the audits we conduct.

- Our objective is not to have environmental and sustainable development issues supersede other significant matters but rather to strike the right balance among the various issues that are important to Canadians.
- The purpose of the sustainable development strategy and the upcoming environmental management system is not to create new systems or impose new inflexible processes. In both cases, existing systems will be used.
- The strategy does not provide answers to all our questions and does not present guidelines on how we will integrate environment and sustainable development into our audit work. This will be achieved through the implementation of our action plan.

For whom is this strategy intended?

37.17 The Office's sustainable development strategy is intended for four main groups:

- Members of Parliament, who are our main clients and who can hold the government to account for the way it takes sustainable development into account in its decision making.
- Our staff, on whom the implementation of this strategy depends. They must be comfortable with the strategy and be able to relate to it.
- Federal government employees and managers, with whom the Office maintains very close contact and who are responsible for integrating sustainable development issues into the policies, programs and operations of federal organizations.
- Canadians, whom the members of Parliament represent and for whom all this Office's staff and government employees work.

What will you find in this document?

37.18 If you have time to read only one page of this document, Exhibit 37.1 on page 37-6 will provide you with the essence of the strategy. It sets out our sustainable development goals and objectives and the key performance indicators. If you have a little more time, Appendix C will provide you with an overview of the action plan and the performance indicators that were developed for the Office.

37.19 If you read more of the document, you will learn about the Office's profile (below), the sustainable development issues associated with our activities (page 37-12) and how we developed our goals, objectives and action plan (page 37-16). Our conclusions are presented on page 37-20.

What Are the Office's Mission and Activities?

Our Mandate

Enabling legislation

37.20 The *Auditor General Act*, the *Financial Administration Act* and a variety of other acts and orders-in-council set out the duties of the Auditor General and the Commissioner of the Environment and Sustainable Development as they relate to legislative auditing and monitoring of federal departments and agencies, Crown corporations and other national and international organizations.

Independence from government

37.21 We are different from departments and agencies by virtue of our independence from the government of the day and our reporting relationship to Parliament. Our independence is assured by a broad legislative mandate, freedom from certain controls over our budget and staff, and a 10-year term for the Auditor General. The first independent Auditor General was appointed in 1878.

The Office's Vision, Mission and Priorities

Strategic framework

37.22 The Office's Strategic Framework reflects a number of areas where we intend to focus our efforts to meet new and greater challenges and to make our Office an even better and more satisfying place to work. The strategic framework is currently being reviewed to incorporate, among other things, the elements of environment and sustainable development. Our Vision and Mission Statement guide our work:

Vision: We are committed to making a difference for the Canadian people by promoting, in all our work for Parliament, answerable, honest and productive government that reflects a commitment to sustainable development.

Mission: The Office of the Auditor General of Canada conducts independent audits and examinations that provide objective information, advice and assurance to Parliament. We promote accountability and best practices in government operations.

Office priorities

37.23 Many parties inside and outside government share a commitment to good government, and it is often through their co-operation and participation that we effect change. We assess our own effectiveness in terms of our ability to conduct high-quality audits that address significant topics and contribute to **making a difference**. Our five priorities for 1996–2001 are:

- To help improve the government's financial condition.
- To stimulate real advances in accountability concepts.
- To influence the quality of financial management.

- To contribute to necessary changes in the public service.
- To implement fully the role of the Commissioner of the Environment and Sustainable Development.

Our Activities

Legislative auditing

37.24 The principal activity of the Office is *legislative auditing*. Put simply, the Auditor General provides his professional opinion on the following questions:

Types of audits conducted and monitoring activities	Provides interested parties with answers to the following questions:
Attest audits of the Financial Statements of the Government of Canada	Is the government presenting fairly its overall financial situation?
Financial annual audits of Crown corporations, federal departmental corporations and other federal entities, territorial governments and organizations, other Canadian entities and international organizations.	Are Crown corporations, federal departmental corporations and other federal entities, territorial governments and organizations, other Canadian entities and international organizations presenting their financial information fairly and complying with relevant legislative authorities?
Value-for-money audits of departments and agencies	Were departmental and agency programs run economically and efficiently, and with regard to their environmental effects? Does the government have the means to measure the effectiveness of programs? Is legislation complied with and the public purse protected?
Special examinations of Crown corporations	Do systems and practices of Crown corporations provide reasonable assurance that assets are safeguarded, resources are managed economically and efficiently, and operations are carried out effectively?
Environment and sustainable development monitoring activities	To what extent did departments meet the objectives and implement the plans set out in their sustainable development strategies laid before the House of Commons?

The Commissioner of the Environment and Sustainable Development

37.25 The Commissioner of the Environment and Sustainable Development has been a major new responsibility within the Office since 1996. The amendments to the *Auditor General Act* require departments to prepare sustainable development strategies and action plans for tabling in Parliament by the responsible minister. Ministers are also required to respond within 120 days to petitions from the public related to sustainable development issues.

37.26 Four objectives will guide the work of the Commissioner over the next two years:

- To provide objective, independent analysis and recommendations to members of Parliament to help them examine the government's environmental and sustainable development activities and hold the government to account.

- To work with federal departments and agencies to help strengthen their capacity to manage environmental and sustainable development issues.
- To address both environmental protection and sustainable development, by emphasizing better decision making within the federal government.
- To continue to focus on key weaknesses in the federal government's management of sustainable development issues identified in previous work by the Office of the Auditor General, and on the success and failure of departments to deal with them.

Reporting to Parliament

37.27 The Auditor General tables his annual report and two periodic reports each year in the House of Commons. The Commissioner, on behalf of the Auditor General, is to report annually to the House on the extent to which departments have met the objectives and implemented the plans set out in their sustainable development strategies. Our work is also reported in other places and forms, according to enabling legislation. Our reports, as well as other information concerning the Office, are accessible on our Internet site at <http://www.oag-bvg.gc.ca>.

International activities

37.28 We contribute to the development and dissemination worldwide of international standards, best practices and training programs in various areas of accounting, auditing and reporting through our involvement in the International Organization of Supreme Audit Institutions (INTOSAI), in the Panel of External Auditors of the United Nations, and in the audit of UN organizations. We also manage a fellowship program for senior auditors from national audit offices of developing nations. Finally, we audit the international activities of Canadian federal departments and agencies.

Our Resources

Organization of the Office

37.29 The Office is organized into three branches: Executive, Corporate Services and Audit Operations, which includes the team of the Commissioner of the Environment and Sustainable Development. Most of the audit staff work out of the head office in Ottawa. Regional offices are located in Vancouver, Edmonton, Winnipeg, Montreal and Halifax.

Resources

37.30 The Office staff is multi-disciplinary: 50 percent are qualified accountants and another 10 percent have postgraduate degrees in other disciplines, including engineering, law, statistics, sociology, history, the environment and economics. For 1996-1997, the Office's financial resources are \$50.1 million and the human resources are 520 employees.

How Can This Office Affect Sustainable Development?

Issues Associated with Our Audit Work

Where can we have an influence on sustainable development?

37.31 The Office has a special status within the government. Unlike departments, it does not develop policies and does not manage programs. Instead, its role is to determine whether the government's programs and policies are administered in a responsible, honest and productive manner. The environmental and sustainable development issues to which we can draw attention, therefore, are the issues faced by the government departments and organizations we audit (see Exhibit 37.2).

Exhibit 37.2

(This exhibit is not available, see the Report)

37.32 There are various facets to our audit work (see page 37-10 for more details on our activities). The extent to which the Office can influence parliamentarians and federal departments and organizations in matters of the environment and sustainable development depends on the nature of our various audit products.

- During **value-for-money (VFM) audits**, we examine whether the departments and territorial governments took into account the effects of their policies, programs and operations on the environment and sustainable development. In the audits that begin after the tabling of the sustainable development strategies, we will ensure that when we examine significant matters, we consider the issues identified by the departments in their strategies.
- Although it is not explicitly required by the *Financial Administration Act*, during **special examinations of Crown corporations** we determine whether the systems and practices in place are appropriate for sound management of the corporation's environmental activities. This determination depends on the types of activities the corporation is involved in and their potential impact on the environment.
- During **financial audits**, we determine whether environmental costs and liabilities were taken into account when preparing the financial information provided by the Government of Canada, the territorial governments, Crown corporations and certain entities, in accordance with the applicable accounting standards.
- **Reviews of departmental sustainable development strategies** will provide us with the opportunity to understand the environmental and sustainable development issues associated with each department's activities. As mentioned earlier, we will take these issues into account during our future value-for-money audits.
- The **petitions** submitted by Canadians will be another source of information to enable us to identify environmental and sustainable development issues that Canadians are concerned about.
- Finally, our **international activities** will help us raise awareness of environmental and sustainable development issues in the national audit offices of developing nations and in various international organizations.

Issues identified in our first Green Report

37.33 In the past decade, the Office has become increasingly active in the environmental arena and has been a pioneer in applying audit principles to the environment. The Office has conducted some 42 audits of matters that

involved a key component related to the environment or sustainable development. A list of these audits is in Appendix D.

37.34 In his first report (March 1997), the Commissioner of the Environment and Sustainable Development identified three key themes stemming from the review of the federal government's performance in the management of environmental and sustainable development issues:

- the implementation gap between objectives and actions;
- a lack of co-ordination and integration; and
- inadequate review of performance and provision of information to Parliament.

We will continue to draw attention to these key weaknesses and to monitor departments' success in improving their practices.

Horizontal and cross-jurisdictional issues: the need for a global picture

37.35 Many of the most pressing environmental and sustainable development issues come under the jurisdiction of several departments and/or several levels of government. Because there is often a lack of co-ordination or integration among organizations, reviewing these horizontal issues poses a special challenge for governments.

37.36 For the Office of the Auditor General, identifying and examining these horizontal issues also represents a challenge in co-ordinating and integrating the work of various audit teams with that of the staff of the Commissioner of the Environment and Sustainable Development. Reviewing departmental sustainable development strategies will provide an opportunity to focus on identifying and analyzing issues and problems common to various departments and agencies.

Adapting to change

37.37 Environmental and sustainable development issues evolve at the same pace as the societies that define them. It is essential for the Office to have the flexibility and vision needed to adapt quickly to these changes, or even to anticipate them. To do this, the Office has a range of tools and practices:

- information gathered from all our audits and from reviewing the departmental sustainable development strategies;
- a series of regional offices across Canada that act as the "eyes and ears" of the Auditor General in the field to identify issues in the provinces and territories;
- petitions from Canadians;
- comments from our staff during consultations on the development and implementation of our sustainable development strategy;
- advice provided by the advisers to the Commissioner of the Environment and Sustainable Development, the members of the Auditor General's Panel of Senior Advisors and the members of our various advisory committees;
- regular meetings and consultations with our various clients and partners;

- seminars and work sessions with our provincial colleagues and colleagues from other national audit offices;
- new concepts and standards developed by various professional associations (for example, the standards for accounting for environmental costs and liabilities, developed by the Canadian Institute of Chartered Accountants).

Issues Associated with Our Day-to-Day Operations

The negative environmental impacts of our day-to-day operations are limited

37.38 The environmental impacts associated with the day-to-day operations of the Office are relatively limited. The Office has no laboratories, nor does it manage Crown land; it generates a very modest amount of purchases and has a one-car “fleet”.

37.39 The issues associated with our day-to-day operations are therefore limited mainly to the following: changing our work and audit habits to help reduce our paper consumption; purchasing environmentally responsible products for our furniture and office supplies; recycling secondary materials; and optimizing travel for our audits. The Office is not the manager of the buildings it occupies, and does not have direct control over energy, water and waste management. We must therefore influence the managers of the buildings we occupy to improve their environmental management.

37.40 With respect to the Office’s human resources, the challenge is to continue to inform and train staff and management in the area of the environment and sustainable development. We must also look at the extent to which innovative work arrangements can reduce the energy costs associated with transportation and contribute to the well-being of employees. Finally, we must ensure that our internal policies are in keeping with our sustainable development objectives. The current parking subsidy, in particular, is not in keeping with these objectives.

How are we currently dealing with these issues?

37.41 The Office played a very active role in introducing electronic work tools: datebooks and mail, the Comprehensive Auditing Manual, methodological guides and reports, databases, timesheets, expense accounts, etc., all of which are available in electronic format. A pilot project currently under way is looking at possibilities for reducing the amount of paper required to document each financial audit. Most staff are in the habit of recycling materials, as indicated in an envirosurvey conducted internally in 1997. Similarly, purchasing policies take environmental considerations into account. However, these measures have not yet been systematically documented. Our environmental management system should be completed by the spring of 1998.

Our Sustainable Development Goals and Objectives

Promoting sustainable development inside and outside this Office

37.42 Exhibit 37.1 shows the sustainable development goals and objectives of the Office as developed in consultation with our staff, clients and partners. These goals and objectives are related to:

- our auditing activities, where we aim to promote sustainable development with our clients and partners;
- our day-to-day operations, where our aim is to promote sustainable development within our own organization;

- the management of our human resources, where we aim to encourage our staff to behave in such a way as to contribute to achieving all of our sustainable goals and objectives.

A long-term perspective

37.43 Generally speaking, the sustainable development goals that we have set for ourselves are in keeping with the results we would like to achieve in the medium or long term. The Office does not have control over these results (outcomes), but its activities may nevertheless have an impact on them and may contribute to their achievement. Measuring long-term outcomes is often difficult, and evaluating the contribution of each stakeholder is always a sensitive matter. Despite these limitations, the examination of our performance in this regard should be a profitable learning exercise.

37.44 Sustainable development objectives generally correspond to short- or medium-term outputs that the Office controls directly through its various activities. These objectives must be measurable and closely related to the long-term goals to which they contribute.

Shared by all our staff

37.45 For an organization to achieve its objectives, two conditions must exist. First, senior management must have made a real commitment. Second, staff must “adopt” the proposed objectives and identify with the activities suggested for achieving them.

37.46 Throughout the development of the Office’s sustainable development strategy, constant attention was paid to these aspects. For example:

- the Auditor General showed his commitment to and interest in the issue of the environment and sustainable development;
- one of the two Deputy Auditors General actively directed the development of the strategy and chaired the Strategy Steering Committee;
- the Steering Committee, comprising senior managers representing the various activities of the Office, contributed directly to developing sustainable development goals and objectives and the major thrusts of the strategy;
- a working group comprising managers and professionals directly involved in audit work, in the Office’s day-to-day operations and in human resources management developed the action plan and the performance indicators for the strategy;
- through the many consultation activities, all staff were able to provide their input and were informed regularly of progress made on the strategy.

Our Sustainable Development Action Plan

Linking the Goals and Objectives to Activities and Performance Indicators

37.47 Appendices C.1, C.2 and C.3 summarize the Office’s sustainable development action plan. These three tables were designed to highlight the links between our sustainable development goals and objectives (the results sought), the activities needed for achieving these objectives, and the results expected, illustrated with the help of performance indicators. The key indicators that will be used in our annual performance reports are presented in Exhibit 37.1.

Selecting the right mix of objectives/activities/indicators

37.48 The choice of sustainable development objectives and, subsequently, activities and performance indicators must reflect the priorities of an organization, the impact of its activities on sustainable development and the balance sought among the various functions/activities.

37.49 For this Office, the importance of audit activities is reflected in our objectives and action plan. The potential impact of our work on sustainable development is primarily a function of the influence we have on parliamentarians and federal organizations through our audit activities. Although the negative effects of our day-to-day operations on the environment are smaller than those of other departments, mitigating them is an important part of an overall strategy. Finally, our objectives and our action plan have to highlight how the success of our strategy is directly related to the ability and commitment of our staff to carry it out.

Implementing Our Action Plan

37.50 As demonstrated by the high rate of attendance at discussion groups and response to the Envirosurvey, and by the comments gathered, most of our staff show a real interest in environmental and sustainable development issues. Further, the vast majority feel that the Office can influence the practices of Parliament and federal organizations in the area of sustainable development (70 percent said we can influence to a certain extent; 19 percent said we can influence significantly).

37.51 Some of the necessary conditions for integrating environmental and sustainable development issues into our audit operations were discussed during the consultation activities:

- fully integrate the new team of the Commissioner of the Environment and Sustainable Development into the Office, and clearly define its role and its links with the audit teams;
- define the process that will help us address horizontal issues;
- facilitate the “lending” of environmental and sustainable development resources from one team to another;
- find the right balance between environmental and sustainable development issues and other potential lines of inquiry;
- provide the resources needed by audit teams in the medium term to examine environmental issues and review departmental sustainable development strategies;

- place as much importance on implementing the Office's strategy as on developing it, and allocate the necessary resources.

Integrating our sustainable development strategy into the Office's operational processes

37.52 To have a real chance of being implemented, our sustainable development strategy will have to be integrated quickly into each of the Office's operating processes: strategic planning, development of methodology, budgeting and production of performance reports. The strategy will also be directly linked to our environmental management system.

Implementing our strategy fully in each regional office

37.53 The Office of the Auditor General has five regional offices. In addition to departmental and Crown corporation auditing, some of these offices conduct financial audits and value-for-money audits for territorial governments. The governments of the Yukon Territory and the Northwest Territories are audited by our Western Canada offices, and the new Nunavut Territory, to be established in 1999, will be audited by our Montreal office. As a result of the important environmental and sustainable development issues associated with the development of these territories and with the departments audited by our regional offices, they will be fully involved in developing and implementing our strategy.

Working with our partners

37.54 Whether in Ottawa or in the regions, the Office is neither the manager nor the sole tenant of the building in which it is accommodated. It therefore has limited control over numerous aspects of its day-to-day operations. In Ottawa, the energy, water and waste in the C.D. Howe Building are managed by Public Works and Government Services Canada. We will therefore work with that Department and the other tenants of the building to achieve some of the objectives of our strategy.

Completing and implementing our environmental management system (EMS)

37.55 We should be able to finalize our environmental management system in the spring of 1998. Many measures were already in place by summer 1997, but the documentation system has not yet been completed.

What our sustainable development action plan will mean for our employees

37.56 The sustainable development action plan has implications for all our staff, particularly for training. Generally, all employees will have the opportunity to improve their knowledge of the environmental and sustainable development aspects associated directly with their work. Auditors will be better able to identify environmental and sustainable development issues that constitute significant matters to be audited (see Exhibit 37.3). The staff of the Corporate Services Branch will be better able to understand the environmental issues associated with the day-to-day operations they manage.

Exhibit 37.3

Examples of Integrating Sustainable Development into Previous Audit Work

“Environmental liabilities of the Government are likely quite significant. However, the Government has not recognized such liabilities in its financial statements because of uncertainties in defining and estimating them. I continue to hold the view that steps can and should be taken now to provide a more complete picture of environmental liabilities and costs in the financial statements.”

(Public Accounts of Canada, 1997)

“In our 1992 Report, we indicated that Canada did not have a national legislative framework for land-based chemical accidents. Such a framework is still not in place.”

(Chapter 35: Follow-up of 1992 audit on Emergency Preparedness in the Federal Government: Accidents Involving Oil and Chemicals, 1997, 35.15)

“When the Fraser River Action Plan was announced in June 1991, there had been little, if any, consultation with the Province of British Columbia, despite the fact that the province is an essential partner in the efforts to clean up and restore the river. Such a lack of early consultation can inhibit timely action and program development by potential partners.”

(Chapter 14: The Control and Clean-up of Freshwater Pollution, 1993, 14.68)

“Some projects had been approved and work begun before an environmental assessment was completed. Meeting the requirements for environmental protection means that departments must ensure that potential adverse effects and mitigating measures are identified before irrevocable funding decisions are made.”

(Chapter 26: Infrastructure Works Program, 1996, 26.93)

“Is Canada’s Constitution environmentally friendly? The Canadian Constitution says nothing about the environment. In several cases, the courts have been called upon to interpret how the Constitution’s division of powers between the federal and the provincial governments applies to environmental issues.”

(Chapter 18: Department of the Environment, 1990, 18.50-52)

37.57 With respect to day-to-day operations, management would also like all employees to contribute to the objectives of the Office by reducing paper consumption, recycling secondary materials and optimizing the use of public transportation and opportunities for making conference calls.

37.58 The Office encourages its 520 employees to set an example through their behaviour in their auditing of departments and Crown corporations, and in their day-to-day activities at work or at home.

Responding to a Challenge: Performance Measurement and Reporting

The question of attribution

37.59 We want to promote sustainable development among parliamentarians, federal organizations and Canadians in general. This is an ambitious goal that we share with a number of other stakeholders, making it difficult to evaluate the extent to which we will have contributed to achieving the desired result.

37.60 Nonetheless, while we cannot accurately specify our contribution to achieving these long-term goals, we can show a logical link between our activities and the results observed. This will be based on a series of indicators involving results associated with short- and medium-term objectives (outputs) and the changes observed in the longer term (outcomes), including changes in behaviour. Taken separately, none of these indicators is perfect. However, used judiciously, together they will enable us to evaluate our influence and our progress toward sustainable development.

Reporting on results: a process of continuous learning and improvement

37.61 Measuring performance is a process of ongoing improvement. In this first sustainable development strategy, we were able to identify performance indicators for each of our objectives. In our next progress reports (1998 and 1999) we will re-evaluate the relevance of each indicator, based on the quality and significance of the information gathered.

37.62 We were able to present reference data (at 1 April 1997 or summer 1997) for only some of the indicators. In several cases, the activity that we want to measure is a new one in the Office, as will be the case with the review of departmental sustainable development strategies starting in the winter of 1998. In the absence of reference data, we did not identify a specific target. In the 1998 progress report, we plan to propose targets for most of the objectives.

What will we do with our performance measures?

37.63 As noted in paragraph 37.52, our sustainable development strategy will be integrated into the Office's management process and into our environmental management system. The follow-up to the strategy will therefore be part of the Office's continuous improvement process. A report will be made to the Executive Committee twice a year. The Strategy Steering Committee, created while the strategy was being developed, will continue its activities to ensure that the Office's activities are adjusted on the basis of the performance achieved.

Looking Forward: Integrating Sustainable Development

Who will review our strategy?

37.64 As with other departments and agencies, the Office's sustainable development strategy will be reviewed by the Commissioner of the Environment and Sustainable Development. The Commissioner's Panel of Environmental Advisors will also be asked to review the strategy.

Updating our strategy and performance indicators

37.65 We plan to follow the same process as other departments. Thus, within three years of first tabling our strategy we will update it. Similarly, we will prepare an annual progress report showing how we have improved our performance in issues of the environment and sustainable development, and whether we have achieved our targets.

37.66 We will integrate this information into the Office's Performance Report submitted annually to the Treasury Board. The key indicators identified in Exhibit 37.1 will be used for this purpose.

What are the aspects we will need to improve in our strategy?

37.67 At the end of a process such as the development of this strategy, it is often difficult to step back far enough to evaluate weaknesses. However, we already know that at least three aspects will need to be improved when our strategy is updated. First, we will begin the consultation process with our clients and partners earlier so that they can more fully influence the development of our strategy rather than react to our proposals. Second, the broader availability of reference data will allow us to identify specific targets for our objectives. And third, we will need to pay more attention to the social dimension of sustainable development.

How is our strategy going to influence our work in the years to come?

37.68 The main influence that our sustainable development strategy will have on the Office will be that we will approach our audit operations in a more integrated and comprehensive manner. Greater attention will also be paid to the horizontal issues that cut across departmental mandates, cross political jurisdictions and even go beyond our national borders.

How will our strategy influence our relationship with Parliament, federal organizations and Canadians?

37.69 The Office's role in the sustainable development strategy process is proactive, not reactive. This means helping parliamentarians and members of territorial legislative assemblies consider the environmental and sustainable development consequences of their legislative and oversight work. It means supporting federal and territorial organizations in their efforts to integrate environmental and sustainable development considerations into their decision making for policies, programs and operations. And it means providing a mechanism for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada.

Appendix A

Strategy Team

Core Team Members

Sylvie Cantin
Lori Elliott
Paul Fowlow
Adriel Gionet
Gisèle Grandbois
Rita Gudziunas-Mankowski
Ginger Stones

SDS Regional Co-ordinators

Francine Bissonnette
Kevin Potter
Geoffrey Robins

Forty percent of our employees contributed to the development of our strategy by organizing or participating in roundtables, sending comments, providing technical or professional support, or by acting as technical advisors.

Appendix B

Summary of Consultation Activities

Our strategy was developed in close consultation with our employees and clients. The structure for managing this initiative, the information and consultation activities carried out, the results obtained and, finally, the integration of the comments gathered throughout the process illustrate how we went about it.

1. How did we prepare our sustainable development strategy?

- The Strategy Management Committee, chaired by the Deputy Auditor General responsible for the Corporate Services Branch, consisted of 11 managers representing the various groups in the Office. This committee was responsible for the overall thrust of the strategy and its oversight. It met nine times over five months and will continue to meet regularly during the first year the strategy is implemented.
- The strategy production “team” consisted of the co-ordinator and five experienced professionals and managers directly involved in operations involving audit, administrative management, professional development and communicating performance information. The “team” was responsible for developing the action plan and the performance indicators. Its members met formally seven times, and there were also a large number of working meetings.
- Some 10 technical advisors from various teams in the Office, with a broad range of expertise in auditing, communicating performance information, relations with Parliament, communications, professional practice, strategic planning and environment were consulted at various stages in development of the Strategy.
- Three regional co-ordinators were identified early on, to facilitate participation of the regional office.

2. Implementation of our consultation and communication plan

One of the very first activities in developing the strategy was the preparation of a consultation and communication plan. This plan showed which information and consultation activities were planned for the various groups concerned (staff, clients and partners), the messages to be conveyed and the timetable. In summary, the plan’s major achievements are:

Internal consultation

- Creation of an electronic database (on Lotus Notes) presenting detailed and regularly updated information on development of the strategy: consultation and communication plan, agendas and minutes of Management Committee meetings, minutes of discussion groups, results of the survey on the environmental behaviour of employees and comments made by employees in this electronic survey, preliminary versions of the goals and objectives of sustainable development, etc.

- Official launch of the strategy in Ottawa and in each of the regional offices. In Ottawa, the Auditor General and the Deputy Auditor General responsible for this initiative took part in the launch, with some one hundred people in attendance. In each of the regional offices, this initial presentation was made by one of the Deputy Auditors General.
- Formation of 17 discussion groups set up to gather the views and comments of some 200 employees in Ottawa, Vancouver and Montreal on the goals and objectives of sustainable development in the Office (first phase of consultation) and on the performance indicators (second phase).
- Carrying out of a survey on the environmental behaviour of employees. 204 employees took part in this electronic survey (out of a possible 520) and more than 100 made comments in response to the questionnaire's three open-ended questions. This survey provided reference data for a number of the performance indicators in the action plan.
- Presentation of the final report on the strategy and discussion of its implementation at the annual employee information day and in connection with working sessions in each of the regional offices.

Consultation with clients and partners

Three main outside groups were consulted in developing our strategy:

- some 20 parliamentarians from among the members of the Standing Committee on the Environment and Sustainable Development and the Standing Committee on Public Accounts of the 35th Parliament, the Environment critics from the Opposition parties and the members of the Standing Senate Committee on Energy, the Environment and Natural Resources;
- some 20 deputy ministers, members of the Sustainable Development Co-ordinating Committee;
- the members of the Panel of Environmental Advisors to the Commissioner of the Environment and Sustainable Development.

These clients and advisors representing various viewpoints and interests in Canadian society were consulted twice. First we sought their comments on our initial version of the goals and objectives of sustainable development in the Office. Later we submitted to them the draft of our strategy report, including our action plan. In total, during the process, some 20 MPs, senators, deputy ministers or advisors passed their comments on to us, some of them during both phases of the consultation.

The general public also had an opportunity to voice their expectations about our strategy. Our website indicated that we were in the process of developing our sustainable development strategy and invited interested individuals and groups to send in their suggestions. As of mid-October, no comments from the public had been received.

Finally, our communication plan contains a number of initiatives aimed at making our partners aware of the various activities in our action plan. We are especially targeting managers and other occupants of the buildings in

which our offices are located. These activities will take place in connection with the implementation of our strategy.

3. Integrating the comments received into our strategy

The comments made in connection with the various communication activities were carefully collated. Hence, formal minutes were taken for all meetings of the Strategy Management Committee and nearly all the discussion groups. The comments expressed in the survey on environmental behaviour were compiled. The many draft documents commented on by members of management, technical advisors and staff members were carefully consulted and retained. All of these documents, together with the letters, Email messages and memos of telephone conversations with our clients and advisors provided us with food for thought at each stage in developing the strategy. We trust that this document faithfully reflects the spirit of the comments received.

Appendix C.1: Our Action Plan for Our Audit Work

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p>Goal: To promote sustainable development by:</p> <ul style="list-style-type: none"> • providing advice and information to parliamentarians and to members of territorial legislative assemblies to help them consider the environmental and sustainable development consequences of their legislative and oversight work; • supporting federal organizations and territorial governments in their efforts to integrate environmental and sustainable development considerations into their decision making for programs and operations; • providing a means for Canadians to draw environmental and sustainable development concerns to the attention of the Government of Canada 			
<p>Objective 1: To incorporate environment and sustainable development as an integral part of our audit work (DAG Audit Op. Branch) <i>Medium-term target:</i> to maintain audit resources for environmental and sustainable development issues to an adequate/balanced level (14 - 15% of total costs/year) <i>Medium-term target:</i> to have an adequate/balanced coverage of environmental and SD issues (10% - 15% of all OAG's observations and recommendations)</p>	<ul style="list-style-type: none"> • Connect environmental and SD issues to the budgeting system by using distinct product and project numbers for these issues • Develop guidelines for incorporating environmental and sustainable development issues into our audits and update the Comprehensive Auditing Manual and the methodological guides (1998-99: Method. & SD) • Integrate environmental and sustainable development considerations into the OAG strategic planning process (VFM audits selection, Strategic Framework, etc.) • Continue working on the integration of the CESD team within the OAG and on the links with the other teams (CESD) • Define the process that will help us address horizontal issues and issues raised by the petition process • Subject the integration process for environmental and sustainable development issues to practice review (Baseline: March 98, follow-up: 2000: Practice Development) 	<ul style="list-style-type: none"> • Office expenditures on environmental and sustainable development issues /% of VFM expenditures (SP & Finance) • Number of chapters per year related to environment and sustainable development (SD) • % of recommendations and observations related to environment and SD (SP & SD) • % of our recommendations related to environment and sustainable development on which satisfactory progress was made (SP and all teams) 	<p>-</p> <p>10 chapters (10/41); (1996)</p> <p>12 % of recommend. and observ.</p> <p>12% fully implem.</p> <p>55% satisfactory (1991-1995)</p>

Note: Responsibility for achieving each objective, implementing each activity and evaluating each indicator is shown in parentheses.

SDS: Sustainable Development Strategy
 SP: Strategic Planning
 PL: Parliamentary Liaison
 SD: Sustainable Development
 HR: Human Resources
 PD: Professional Development
 IT: Information Technologies

VFM: Value-for-money auditing
 MP: Member of Parliament
 DM: Deputy Minister
 DG: Director General
 AG: Auditor General
 DAG: Deputy Auditor General

AAG: Assistant Auditor General
 CESD: Commissioner of the Environment and Sustainable Development
 PWGSC: Public Works and Government Services Canada
 INTOSAI: International Organization of Supreme Audit Institutions
 IDI: INTOSAI Development Initiative
 CCAF: Canadian Comprehensive Auditing Foundation

Appendix C.1 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p><i>Medium-term target:</i> to increase the usefulness of our reporting to Parliament</p>	<ul style="list-style-type: none"> • Systematically consider environmental and SD issues in our audit work: <ul style="list-style-type: none"> - VFM: when deciding on audit scope; - Special exams: when deciding on important issues to examine; - Annual audits: reporting of environmental costs and liabilities in accordance with appropriate accounting standards <ul style="list-style-type: none"> • Document systematically in new audits starting in 1998 the fact that environmental and SD issues were considered : - VFM: in overview and survey reports; - Special exams: in the planning documents to advisory committee; - Annual audits: in checklist and planning memorandums • Develop for March 1998 an OAG survey to determine the satisfaction level of MPs with the work of the OAG. The survey will be sent out at the beginning and at the end of a new Parliament (SP, PL & SD) • Through our international activities (especially activities such as INTOSAI and the IDI and Fellowship training programs), raise awareness of environmental and SD issues in the national audit offices of developing nations and in various international organizations (International Affairs) • Work with provincial colleagues to ensure that cross-jurisdictional issues are covered • Integrate environmental and SD reporting into OAG performance reporting (1997-98: SP) 	<ul style="list-style-type: none"> • % of chapters and % of special exams reviewed by the Practice Development team that integrated environmental and SD issues (Practice Development) • % of audit planning documents that considered whether environmental and SD issues were significant audit matters (SD) • % of parliamentarians who feel that our work has helped them - who better understand issues and who use our chapters (SP) • % of OAG references in the House of Commons and the Senate that were about environmental and SD issues (PL) • Number of parliamentary committee hearings on environmental and SD issues using our chapters (SD) 	<p>-</p> <p>-</p> <p>-</p> <p>8% of all OAG references (15/185)</p> <p>24 committee hearings (1996-97)</p>

Appendix C.1 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p>Objective 2: To monitor the extent to which federal organizations have met the objectives and implemented the action plans set out in their SD strategies (CESD) <i>Short-term target:</i> 100% compliance with the Auditor General Act</p>	<ul style="list-style-type: none"> Develop criteria for reviewing SDS and progress reports on the implementation of SDS and action plans (1997-98: SD and all teams) Inform organizations of OAG expectations with respect to SDS (1997-98: SD) Review the SDSs and include the observations in our reports (1998: SD and all teams) Review the progress reports on the implementation of SDS and action plans and include the observations in our reports (1999: SD and all teams) 	<ul style="list-style-type: none"> % of organizations that prepared their SDS and progress reports as required (SD) For each of our criteria, percentage of SDS and progress reports that were very satisfactory/ relatively satisfactory/not satisfactory (SD) % of objectives for which the organizations identified satisfactory performance indicators on outputs and outcomes (SD) % of objectives for which the organizations measured the results achieved in their progress reports, in relation to the indicators defined in the SDS (SD) % of objectives for which the measures of results presented in the organizations' progress reports showed an improvement (SD) Number of federal organizations that improved their environmental and sustainable development reporting and performance - significantly/to some extent/very little (SD and all teams) 	<p>-</p> <p>-</p> <p>-</p> <p>-</p> <p>-</p> <p>-</p> <p>-</p>
<p>Objective 3: To help strengthen the capacity of federal and territorial organizations to manage environmental and sustainable development issues (AG, DAGs and all AAGs) <i>Short-term target:</i> to increase the number of observations describing good practices in the management of environmental and SD issues <i>Short-term target (2 years):</i> Increase the number of federal organizations preparing SDS or reporting on SD using other means</p>	<ul style="list-style-type: none"> Develop appropriate tools to help organizations manage environmental and SD issues (SD) Identify and report on good practices in the management of environmental and SD issues (SD and all teams) Encourage large federal organizations that are not required to develop SDS to do so or to report on SD issues using other means (1998-99: Group 10, AAGs & CESD) Develop for March 1998 an OAG survey to determine the satisfaction level of assistant DMs and DGs with the work of the OAG. The survey will be sent out a few months after the tabling of each AG periodic report (SP & SD) 	<ul style="list-style-type: none"> Number of chapters/observations related to good practices in the management of environmental and sustainable development issues (SD) Number of federal organizations that were not required to prepare SDS that did so or that reported on SD issues using other means (SD) % of assistant deputy ministers and directors general who feel that our reports have helped them to better integrate sustainable development issues (SP) 	<p>4 chapters (15 observations)</p> <p>-</p> <p>-</p>

Appendix C.1 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p>Objective 4:</p> <p>To monitor the replies by departments to petitions made by Canadians about environmental and sustainable development concerns</p> <p>(CESD, on behalf of AG)</p>	<ul style="list-style-type: none"> Monitor the replies by departments to petitions (Starting March 1997: CESD) Prepare a communication plan to ensure that Canadians know the role of the CESD (1997-98: SD and Communications) 	<ul style="list-style-type: none"> Number of petitions received and % of petitions where the prescribed response delays were met by departments (SD) % of the OAG's coverage in the media (press) after report tabling that involved environmental and sustainable development issues (Communications) % of activity on the OAG's website related to the Commissioner of the Environment and Sustainable Development and to the OAG's SDS (Communications) 	<p>1 (1996-97)</p> <p>4.3% (30-700 mentions) (1996-97)</p> <p>CESD site opened March 1997</p>

Appendix C.2: Our Action Plan for Our Administrative Activities

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
Goal: To optimize the use of natural resources and to minimize the negative environmental impacts of the OAG's day-to-day operations			
Objective 1: To complete and implement our Environmental Management System (EMS) (DAG Corporate Services Branch)	<ul style="list-style-type: none"> complete and implement our environmental management system by Spring 98 (Corporate Services Branch) 		
Objective 2: To reduce paper and paper product consumption (DAG Corporate Services Branch) <i>1-year target:</i> reduce paper consumption per employee by 5% <i>1-year target:</i> to reduce the number of paper forms by 15 %	<ul style="list-style-type: none"> adjust copiers to 2-sided defaults and continue to improve copiers' reliability (1997: Materiel) explain to all staff how to adjust their network printers to print 2-sided as a default (1997: IT) review current practices on reusing paper (1997-98) encourage use of electronic media and train everybody on how to do electronic filing (1997-98: IT & PD) continue reviewing the audit documentation process (1997-98) review all forms and reduce number of paper forms (1997-98: Materiel) 	<ul style="list-style-type: none"> Quantity of paper consumed per chapter and per employee¹ (Materiel) Number of photocopies produced per chapter and per employee (Materiel) % of staff who usually: <ul style="list-style-type: none"> - photocopy double-sided 15% - print double-sided 33% - reuse paper 51% - who are satisfied that electronic filing facilitates work (PD) (Enviro Survey July 1997) (to develop) - % of audit documentation in electronic format 122 paper forms (April 1997) Number of paper forms or % of forms in electronic format (Materiel) 	113,000 sheets/chapter; 9,040 sheets/employee 69,418 copies/chapter; 5,553 copies/employee (1996-97) 28% 15% 33% 51% (Enviro Survey July 1997) - 122 paper forms (April 1997)

¹ Consumption of paper refers to dual purpose paper (DP), the paper used for our photocopiers and network printers. Number of employees is a full-time equivalent (FTE)

Appendix C.2 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
Objective 3: To increase the “greenness” of our purchases (DAG Corporate Services Branch)	<ul style="list-style-type: none"> Create a list of all stocked items, determine their “greenness” and identify other “green” options - Ecologo approval, recycled content and post-consumer recycled content, etc.- (1998: Materiel) Train staff involved in purchasing activities (1998: Materiel & PD) 	(to develop - short-term) <ul style="list-style-type: none"> % of products stocked that are Ecologo products % of products stocked that come from recycled material (Materiel) (to develop - medium-term) <ul style="list-style-type: none"> % of “green” furniture and equipment purchased (Materiel) 	-
Objective 4: To reduce energy and water consumption (DAG Corporate Services Branch)	<ul style="list-style-type: none"> Meet and work with PWGSC property management and other building tenants to ensure that SD issues (energy and water consumption, waste management, air quality, materiel use) are addressed in all building maintenance activities and in the upcoming building refit (Facilities) 	<ul style="list-style-type: none"> These indicators will be developed when planning the building refit. Right now, we have no way to measure our energy and water consumption 	-
Objective 5: To maximize the capture of recyclable material / Reduce waste production (DAG Corporate Services Branch) <i>Year 2000 target:</i> Reduce waste by 50% using 1988 as base year ??	<ul style="list-style-type: none"> Encourage PWGSC to do annual waste audits (Facilities) 	(to develop) <ul style="list-style-type: none"> % of recyclable material that is recycled % of our waste that is recycled (to develop) <ul style="list-style-type: none"> quantity of waste per employee 	- we don't have a baseline for 1988
Objective 6: To encourage the use of environmentally responsible transportation for our audit work whenever it is time-efficient / to encourage the use of teleconferencing (not to the detriment of good co-ordination with our regional offices and clients) (DAG Corporate Services Branch)	<ul style="list-style-type: none"> Enhance the quality and availability of teleconferencing facilities (1998 Telecommunications) 	<ul style="list-style-type: none"> % of our audit work intercity travelling (downtown to downtown) that uses public transportation or car pooling (Finance) 	-

Note: all education and awareness activities are presented in Appendix C.3 “Our Action Plan for Our Human Resources.”

Appendix C.3: Our Action Plan for Our Human Resources

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p>Goal:</p> <p>To support activities that recognize our employees as our greatest assets in pursuing our sustainable development goals</p>			
<p>Objective 1:</p> <p>Enhance the capability of OAG staff to recognize and integrate sustainable development related issues into their audit work (DAG Corporate Services Branch)</p>	<ul style="list-style-type: none"> • prepare a competency model including environment and SD (1997: HR) • prepare an electronic self–assessment tool including general environment and SD competencies (Fall 1997: HR) • prepare an electronic self–assessment tool focussing on specific environment and SD competencies (1997-1998: HR, PD & SD) • develop a training plan to address SD competency gaps/needs of teams (1997-98: PD & SD) • design, develop and deliver training sessions that enable staff to identify and integrate environmental and SD issues into their audit work (1998: PD, CESD & all teams) 	<ul style="list-style-type: none"> • % of OAG employees who consider that they know “a fair amount–quite a lot” in terms of SD knowledge (PD) • self–assessment of “organizational SD effectiveness” and of “personal SD effectiveness” (HR) • self–assessment of specific environment & SD knowledge (PD & SD) • % of staff who participated in SD training sessions (PD) • self–assessment of ability to recognize SD–related audit issues (training session evaluations) (PD) • % of OAG employees who believe that the Office’s efforts in sustainable development could positively influence the practices of Parliament and federal organizations (PD) 	<p>A fair amount:33% Quite a lot:10% (EnviroSurvey, July 97)</p> <p>-</p> <p>-</p> <p>-</p> <p>-</p> <p>-</p> <p>to some extent: 70% to a significant extent: 19% (July 1997)</p>

Appendix C.3 (cont'd)

Sustainable development goals, objectives and targets (intended results)	Activities to achieve these objectives	Results achieved: performance indicators	
		Performance indicators	Baseline
<p>Objective 2:</p> <p>Increase OAG staff awareness and practice of SD efforts in the Office's day-to-day operations and society at large (DAG Corporate Services Branch)</p> <p><i>Short-term target:</i> one information activity every two months</p>	<ul style="list-style-type: none"> • design and administer an office-wide questionnaire (Envirosurvey) to establish current base of knowledge, attitudes and behaviours (July 1997: PD & SD) • present information sessions on different topics - e.g. OAG SD strategy, benefits of car pooling, green purchasing ((SD, PD & teams) • present SD tip of the month in 'quoi de neuf', Interim or other communication vehicle (Communications, SD and teams) • encourage innovative work arrangements (HR) • as part of the continuous review of the employee's compensation plan, eliminate the parking subsidy (1997-98: HR) • encourage Treasury Board to replace the parking subsidy with a neutral compensation (1997-98: CESD) • encourage PWGSC management to install secure bike racks in C. D. Howe Building (1997-98: Facilities) • contact regional transportation authorities to propose OAG as pilot project to increase ridership (1997-98) • create a database for car pooling for C.D. Howe Building's occupants (1997-98: ? & IT) • create and display stickers in front of the elevators to encourage using the stairs (1997: Facilities) 	<ul style="list-style-type: none"> • % of employees who consider themselves to be actively committed in terms of environmentally sound behaviours (PD) • number of sessions held/ number of persons who attended (SD) • % of employees currently taking advantage of alternative work arrangements, especially energy-efficient ones (HR) • % of employees who car pool, park and ride, take the bus, walk or bike or rollerblade to work (PD) • number of new OAG bus users following pilot project • number of registrations on the car pooling database (IT) • % of employees who take the stairs for short trips in most circumstances (PD) 	<p>40% (July 1997)</p> <p>-</p> <p>23% compressed work week (120/520); 4% part-time (20/520); 2 self-funded leave (1997)</p> <p>72% (July 97)</p> <p>-</p> <p>-</p> <p>47% (July 97)</p>

APPENDIX D

Environmental and Sustainable Development Work by the Office, 1990 to 1999

Reference	Title	Departments/Agencies
1999	Promotion of the Mining Sector	Natural Resources Canada
	Weather Services	Environment Canada
	Sustainable Development Strategies	24 departments and agencies
	Climate Change II	Environment Canada
	Environmental Information	Environment Canada
	Hazardous Material	National Defence
	NAFTA - Environmental Impact	Revenue Canada
	Enforcement in Ecosystem Management	Environment Canada
	International Obligations: Developing Canada's Position	
	Managing for Sustainable Development	
	Accounting for Sustainable Development II	
	Ensuring a Sustainable Salmon Fishery	Fisheries and Oceans
December 1998	Sustainable Fisheries: East Coast	Fisheries and Oceans
May 1998	Sustainable Development Strategies	24 departments and agencies
	Biodiversity	Environment Canada
	Meeting Our International Obligations	
	Public and Private Sector Performance	
	Performance Measurement	
	Accounting for Sustainable Development	
	Environmental Assessment	Environment Canada
	Climate Change	
December 1997	Agriculture: Prairie Farm Rehabilitation Administration	Agriculture and Agri-Food Canada
	Fisheries and Oceans: Pacific Salmon Management	Fisheries and Oceans
	Environment Canada: Ozone Layer Protection	Environment Canada and 12 departments and agencies
October 1997 Chapter 14	Fisheries and Oceans - Sustainable Fisheries Framework: Atlantic Groundfish	Fisheries and Oceans
Chapter 15	Fisheries and Oceans: Rationalization and Renewal - The Atlantic Groundfish Strategy	Fisheries and Oceans
Chapter 16	Human Resources Development Canada - The Atlantic Groundfish Strategy	Human Resources and Development Canada
April 1997 Chapter 4	Control of the Transboundary Movement of Hazardous Waste	Environment Canada
Chapter 10	Natural Resources Canada: Energy Efficiency	Natural Resources Canada
March 1997	First Report of the Commissioner of the Environment and Sustainable Development	

APPENDIX D (cont'd)

Reference	Title	Departments/Agencies
November 1996 Chapter 22	Federal Contaminated Sites - Management Information on Environmental Costs and Liabilities	Treasury Board Secretariat, Environment, National Defence, Transport, Indian Affairs and Northern Development
Chapter 26	Canada Infrastructure Works Program - Lessons Learned	Treasury Board Secretariat, Industry, Indian Affairs and Northern Development, Western Economic Diversification, Federal Office of Regional Development - Quebec, Atlantic Canada Opportunities Agency
Chapter 31	Parks Canada: Preserving Canada's National Heritage	Heritage
Chapter 39	Other Audit Observations - AECL	Atomic Energy of Canada Limited
May 1996 Chapter 2	The Implementation of Federal Environmental Stewardship	Environment, all Departments
Chapter 9	Animal and Plant Health: Inspection and Regulation	Agriculture and Agri-Food
October 1995 Chapter 11	Environmental Management Systems: A Principle-Based Approach	Treasury Board Secretariat, Environment
Chapter 15	Northumberland Strait Crossing Project	Public Works and Government Services
May 1995 Chapter 2	Managing the Legacy of Hazardous Waste	Environment
Chapter 3	Federal Radioactive Waste Management	Natural Resources, Atomic Energy Control Board
1994 Chapter 9	Science and Technology - Overall Management of Federal Science and Technology Activities	Some Departments
Chapter 10	Science and Technology - Management of Departmental Science and Technology Activities	Environment, Fisheries and Oceans, Industry, National Research Council, Natural Resources
Chapter 11	Science and Technology - The Management of Scientific Personnel in Federal Research Establishments	Environment, Fisheries and Oceans, Industry, Natural Resources, Treasury Board Secretariat
Chapter 12	Aspects of Federal Real Property Management	National Defence, Public Works, Correctional Services Canada, Foreign Affairs and International Trade
Chapter 15	Atomic Energy Control Board - Canada's Nuclear Regulator	Atomic Energy Control Board
Chapter 19	Environmental Partners Fund	Environment
Chapter 20	Environment Canada - Ice Services	Environment
Chapter 27	National Defence - Infrastructure Management	National Defence
Chapter 34	Management and Operation of Crown-owned Office Buildings	Public Works
1993 Chapter 13	Agri-Food Policy Review	Agriculture
Chapter 14	The Control and Clean-up of Freshwater Pollution	Environment
Chapter 15	Northern Cod Adjustment and Recovery Program	Fisheries and Oceans
Chapter 16	Department of Forestry	Forestry
Chapter 26	Pulp and Paper Regulations	Environment
1992 Chapter 12	Participation In the World Bank Group and the IMF	Finance
Chapter 14	Energy Megaprojects	Energy, Mines and Resources
Chapter 24	Emergency Preparedness in the Federal Government	Emergency Preparedness, Transport, Environment, Employment and Immigration, Communications, National Defence, Health and Welfare, Energy Mines and Resources, Industry Science and Technology

APPENDIX D (cont'd)

Reference	Title	Departments/Agencies
1991 Chapter 7	Vehicle Fleet Management	Supply and Services, National Defence, Royal Canadian Mounted Police, Transport, Agriculture, Public Works
Chapter 11	Conservation and Protection	Environment
Chapter 13	Central and Arctic Operations	Fisheries and Oceans
Chapter 15	Customs and Excise (Hazardous Materials)	Revenue Canada
1990 Chapter 18	Department of the Environment	Environment
Chapter 19	Northern Affairs Program	Indian Affairs and Northern Development
Chapter 26	RCMP - Federal Law Enforcement	Royal Canadian Mounted Police

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APPENDIX A

AUDITOR GENERAL ACT

R.S.C., c. A-17

An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting
1995, c. 43, s.1.

SHORT TITLE

Short title 1. This Act may be cited as the *Auditor General Act*. 1976–77, c. 34, s.1.

INTERPRETATION

Definitions 2. In this Act,

“appropriate Minister” “appropriate Minister” has the meaning assigned by section 2 of the *Financial Administration Act*;

“Auditor General” “Auditor General” means the Auditor General of Canada appointed pursuant to subsection 3(1);

“category I department” “category I department” means

 (a) any department named in Schedule I to the *Financial Administration Act*,

 (b) any department in respect of which a direction has been made under subsection 24(3), and

 (c) any department, as defined in the *Financial Administration Act*, set out in the schedule;

“Commissioner” “Commissioner” means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

“Crown corporation” “Crown corporation” has the meaning assigned to that expression by section 83 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*;

“sustainable development” “sustainable development” means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

“sustainable development strategy” “sustainable development strategy”, with respect to a category I department, means the department’s objectives, and plans of action, to further sustainable development. 1976–77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

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. 1976-77, c. 34, s. 3.
- Salary** 4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.
- 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. 1976-77, c. 34, s. 4; 1980-81-82-83, c. 50, s. 23, c. 55, s. 1.

DUTIES

- Examination** 5. The Auditor General is the auditor of 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. 1976-77, c. 34, s. 5.
- Idem** 6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or 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. 1976-77, c. 34, s. 6; 1980-81-82-83, c. 170, s. 25.
- Annual and additional reports to the House of Commons** 7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year 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;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual 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 December 31 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 receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976-77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

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 the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

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 19(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. 1976-77, c. 34, s. 8; 1994, c. 32, s. 3.

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. 1976-77, c. 34, s. 9.

- 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. 1976–77, c. 34, s.10.
- 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. 1976–77, c. 34, s. 11.
- 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. 1976–77, c. 34, s. 12.

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*. 1976–77, c. 34, s.13.
- 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 any 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. 1976–77, c. 34, s. 14.

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 section 21 of that Act and inquiries under section 34 of that Act.
- Suspension** (4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976–77, c. 34, s. 15; 1992, c. 54, s. 79.
- Appointment of Commissioner** **15.1** (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.
- Commissioner's duties** (2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.
- 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 7(1)(e) and sections 11 to 13 of that Act. 1976–77, c. 34, s. 16.
- Classification standards** **17.** 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. 1976–77, c. 34, s. 18.
- Delegation** **18.** 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 64 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. 1976–77, c. 34, s. 19.
- ### ESTIMATES
- Estimates** **19.** (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. 1976–77, c. 34, s. 20.
- Appropriation** **20.** The provisions of the *Financial Administration Act* with respect to the division

allotments of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976–77, c. 34, s. 21.

AUDIT OF THE OFFICE OF THE AUDITOR GENERAL

Audit of the office of the Auditor General **21.** (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 report 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. 1976–77, c. 34, s. 22.

SUSTAINABLE DEVELOPMENT

Purpose **21.1** The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

- (a) the integration of the environment and the economy;
- (b) protecting the health of Canadians;
- (c) protecting ecosystems;
- (d) meeting international obligations;
- (e) promoting equity;
- (f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
- (g) preventing pollution; and
- (h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received **22.** (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent (2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond (3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

- (a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or
- (b) any longer time, where the Minister personally, within those one hundred and twenty

days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more than one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and

(b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

(a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;

(b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and

(c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.

Strategies to be tabled

24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons

(a) within two years after this subsection comes into force; or

(b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council

(4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

APPENDIX B
FINANCIAL ADMINISTRATION ACT

R.S., c. F-11

Extracts from Part X

CROWN CORPORATIONS

Financial Management

- Books and systems** 131. (1) Each parent Crown corporation shall cause
- (a) books of account and records in relation thereto to be kept, and
 - (b) financial and management control and information systems and management practices to be maintained,
- in respect of itself and each of its wholly-owned subsidiaries, if any.
- Idem** (2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that
- (a) the assets of the corporation and each subsidiary are safeguarded and controlled;
 - (b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and
 - (c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.
- Internal audit** (3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.
- Financial statements** (4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.
- Form of financial statements** (5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations (6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report 132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents (2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations (3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports (4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information (5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports (6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in

Council may require.

- Examination** (7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).
- Reliance on internal audit** (8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s. 42.
- Errors and omissions** 133. (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.
- Idem** (2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.
- Correction** (3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

- Appointment of auditor** 134. (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.
- Auditor General** (2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.
- Idem** (3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.
- Exception** (4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.
- Criteria for** (5) The Governor in Council may make regulations prescribing the criteria to be

appointment	applied in selecting an auditor for appointment pursuant to subsection (1) or (4).
Re-appointment	(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.
Continuation in office	(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.
Persons not eligible	135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.
Independence	(2) For the purpose of this section, <ul style="list-style-type: none"> (a) independence is a question of fact; and (b) a person is deemed not to be independent if that person or any of his business partners <ul style="list-style-type: none"> (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates, (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or (iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.
Resignation	(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.
Qualifications preserved	136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.
Resignation	137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination	138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of
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paragraphs 131(2)(a) and (c).

Time for examination (2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan (3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements (4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit (5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

Report 139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents (2) The report of an examiner under subsection (1) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

Special report of appropriate Minister 140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

Special report to Parliament 141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

Examiner	142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.
Idem	(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.
Exception	(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.
Applicable provisions	(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.
Auditor General eligible	(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General	143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.
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Right to Information

Right to information	144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such <ul style="list-style-type: none"> (a) information and explanations, and (b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.
Idem	(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall <ul style="list-style-type: none"> (a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the

present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports (3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction 145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege 146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination 147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem (2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee 148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem (2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

- Duties** (3) The audit committee of a parent Crown corporation shall
- (a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;
 - (b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);
 - (c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);
 - (d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and
 - (e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance (4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting (5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary (6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister 149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments (2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly- (3) Each parent Crown corporation shall forthwith notify the appropriate Minister

owned subsidiaries	and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.
Annual report	150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.
Reference to committee	(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.
Form and content	(3) The annual report of a parent Crown corporation shall include <ul style="list-style-type: none"> (a) the financial statements of the corporation referred to in section 131, (b) the annual auditor's report referred to in subsection 132(1), (c) a statement on the extent to which the corporation has met its objectives for the financial year, (d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and (e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report, <p>and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.</p>
Idem	(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.
Annual consolidated report	151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.
Reference to committee	(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.
Contents	(3) The annual consolidated report referred to in subsection (1) shall include <ul style="list-style-type: none"> (a) a list naming, as of a specified date, all Crown corporations and all corporations of

which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c. 31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

APPENDIX C

REPORTS TO THE HOUSE

Monday, 28 October 1996

The Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 1 of the Auditor General's May 1996 Report (Other Audit Observations — Revenue Canada). The Committee held meetings on this subject with representatives from the Departments of Finance, Revenue Canada and the Office of the Auditor General on May 16 and October 2, 1996.

Introduction

The Standing Committee on Public Accounts thanks the Auditor General for his report and for his willingness to appear before the Committee on several occasions. In particular, the Committee would like to thank the Auditor General for bringing to our attention the issue of Taxable Canadian Property and the decision that was made in December, 1991.

The Committee acknowledges the important work of the Auditor General and expresses appreciation for the productive relationship between the Auditor General and the Committee. The Committee also wishes to thank those who took the time to answer the Committee's questions with regard to Chapter 1 of the May 1996 Auditor General's Report.

The issues raised in Chapter 1 of the May 1996 Auditor General's report concerning the taxation of emigrants were referred to both the Standing Committee on Finance and the Standing Committee on Public Accounts. The Standing Committee on Finance heard from a wide range of witnesses and examined the issues relating both to the process and to the policy related to tax rulings given in 1985 and 1991. The Standing Committee on Finance issued its report in September 1996, with a series of recommendations affecting both the advance rulings process and the policy of the taxation of emigrants.

The Minister of Finance tabled a Notice of Ways and Means Motion on October 2, 1996 which implemented the policy recommendations put forward by the Standing Committee on Finance and tightened Canada's already strict rules for taxpayer migration. The Committee is pleased that the Auditor General expressed satisfaction with the Government's response to the issues raised in his report.

The Standing Committee on Public Accounts notes the Auditor General's remarks with regard to the statement by the Minister of Finance on October 2, 1996:

If I may add my own views on this. I must say that we saw the Minister of Finance's announcement for the first time this afternoon, just before the start of this hearing, so my comments are preliminary comments, and I will need a little more time to review the technical details.

With that qualification, I would nevertheless say that at first glance the response appears to be a fairly thorough response to the concerns that we have raised, and I am pleased by the seriousness with which our concerns have been taken.

It seems as though the changes proposed would definitely clarify the legislation and it also seems that the changes proposed go in the direction that I thought was the basic intent of the law, of the *Income Tax Act* and of Parliament. In fact, very quickly, I noted some of the technical changes very similar to some of the comments we made during testimony to the Finance Committee. I think from what I've seen so far, the changes seem to respond to the concerns that we've expressed before now.

For its part, the Standing Committee on Public Accounts heard from many of the same witnesses who appeared before the Standing Committee on Finance concerning the 1985 and 1991 rulings. From this testimony, there are several issues that the Standing Committee on Public Accounts would like to highlight in this report.

Documentation:

The Committee is concerned about the lack of documentation of the December 23, 1991 meetings held by officials to discuss this ruling. The Committee believes that rulings outlining the interpretation of tax policy should be well documented, consistent and transparent.

The Committee is pleased that, in May 1996, when the Minister of National Revenue was made aware of this problem she acted immediately to ensure that all tax policy interpretations are properly documented.

Granting of an advance tax ruling:

The Committee also examined whether the advance ruling in 1991 should have been given at all. The Committee notes that in determining whether to give the rulings, Revenue Canada was confronted with ambiguous legislation. The Auditor General, in confirming that the legislation was ambiguous, stated before this Committee: "This observation highlights significant ambiguities in the *Income Tax Act* relating to the concept of taxable Canadian property."

Faced with the ambiguous legislation, Revenue Canada consulted with both the Department of Finance and the Department of Justice. Given that Revenue Canada received advice that a positive ruling would be in accordance with both a proper interpretation of the law and its policy, the Committee believes that Revenue Canada was correct in issuing the advance tax ruling.

Integrity of officials involved:

In its investigation of this issue, the Committee found no evidence to doubt the integrity of the officials involved in making this advance ruling. The Committee also notes that the Auditor General said in his testimony to the Committee that:

In the dealings that we've had with Revenue Canada, and particularly since I've been Auditor General we've had a lot of dealings with Revenue Canada, I have never had the occasion or the need to ever question the integrity of the senior officials at Revenue Canada.

Recommendations:

1. The Committee recommends that the substantive conclusions of the Standing Committee on Finance as outlined in the appendix of the Third Report of the Standing Committee on Finance be adopted.

2. The Committee believes that the lack of a system to ensure consistency of rulings, the lack of documentation and the failure to publish rulings were problems which existed at the time that the 1985 and 1991 advance tax rulings were given. However, the Committee notes that changes in the advance rulings process have since been made to address both the concerns of the Auditor General and the recommendations of the Standing Committee on Finance.

The Committee recommends that the Minister of National Revenue ensure that the reforms made to the advance rulings process continue in the future to fully adhere to the goals of transparency, consistency and better documentation.

3. The Committee recommends that following the Minister of National Revenue's announcement that in future all tax policy interpretations be properly documented, that the Minister of National Revenue table the procedure which must now be followed in documenting important decisions.

The dissenting opinions of the Bloc Québécois and the Reform Party, as well as the supplementary opinion of Denis Paradis, are appended to this Report.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (Issue No. 2 which includes this Report) is tabled.

Respectfully submitted,

Michel Guimond

Chair

Dissenting Opinion — Family Trusts Scandal

Bloc Québécois

Institutionalisation of a shameless cover-up

Introduction

The tabling of this new report by the Liberal majority of the Public Accounts Committee on the family trusts scandal fits in directly with the government's cover-up of a financial and fiscal scandal unprecedented in Canada. The Public Accounts Committee should shed light on all of the obscure events surrounding the decision of December 23, 1991, leaving the technical part on necessary fiscal changes to the Finance Committee.

Following the uncovering of this scandal, many Liberal committee members displayed outrage at the actions of Revenue Canada and the Finance Department. The unruly Liberal MPs quickly fell into step with the government partisanship which is in every way trying to protect very, very highly-placed interests of which the financial implications are now evident.

No lack of integrity?

To justify its ineptitude and its lack of courage, the Liberal majority maintains that the Committee found no element for which to cast doubt on the integrity of bureaucrats involved in the making of this premature decision. (Majority Report, p. 5) Liberal MPs are being hypocritical and even naive in pretending to be able to pass judgement on the integrity of the bureaucrats involved. All of the Liberal MPs' actions during the Committee meetings were a shameless attempt to bury the affair by trying to conceal the facts.

How can they really pretend to be shedding light on this entire scandal? First of all, they refused to let the Committee fulfil its mandate. Then, they refused to let the Committee make use of all of its investigative powers. They also refused the Committee the right to hear from all of the bureaucrats involved. And finally, they allowed the Committee no more than two hearings on this scandal. Shedding all of the light? That was certainly the last thing the Liberal MPs had in mind.

However much the latter try to use the Auditor General's statements (Majority Report, p. 5) to back them up, they deliberately omit to point out that the Auditor General clearly specifies that his office has not conducted an inquiry particularly directed at questions of interference or lack of integrity. His office's inquiry was focused on the technical interpretation given to the interpretation request. (Public Accounts Committee, May 8, 1996 and October 2, 1996)

Now, the role of ensuring the integrity of the public service directly belongs to the Public Accounts Committee, as the guardian of governmental accountability. The Committee's Liberal majority clearly abdicated its responsibilities. In effect, the analysis of some testimonies before the Committee show the blind intentions made evident by the Liberal MPs.

Inconsistencies, inexactitudes, lapses and differing versions

More than a dozen inconsistencies, inexactitudes, lapses and differing versions have arisen throughout testimonies, notably by the Revenue deputy minister, a key player in the December 23, 1991 decision. In refusing to note one single example, the Liberal MPs have succeeded in institutionalising this scandal by placing at the government's service the sole parliamentary committee responsible for overseeing the machinery of government's accountability. Here are some examples of the Liberal majority's lack of courage and willpower:

- Firstly, a briefing note written on Sunday, December 22, 1991 by a Revenue Canada employee, on his own initiative, rendered an unfavourable decision with respect to the taxpayer. In commenting on this famous note, the Deputy Minister of Revenue let on that this briefing note was only a routine procedure in the event that an unfavourable decision was rendered. (Public Accounts Committee, October 2, 1996) It turns out that this was the first time that the Auditor General, for whom this note had great importance, had heard this explanation from Revenue Canada, on that same day, during the Committee meeting. (Public Accounts Committee, October 2, 1996) Yet, Revenue Canada and the Auditor General had been working together on this issue for months. The Liberals made no mention of this in their report.
- Next, Revenue Canada usually refuses to render advance income tax rulings on past transactions. Now, the Auditor General clearly revealed that Revenue Canada's decision dealt with past transactions. Even at the Committee's last meeting, the differences between Revenue Canada and the Auditor General persisted. Once again, no mention in the Liberals' report.
- As well, the Deputy Minister of Revenue acknowledged that fiscal effects of the advance income tax ruling had not been evaluated. So Revenue Canada permitted the transfer of more than \$2 billion to the United States without any tax being paid, and without assessing the possible impact of such an important decision on Canada's tax base. The Liberals refuse to include these serious lapses in their report.
- Furthermore, during the last meeting the Deputy Minister of Revenue swore that the waiver signed by the taxpayer had no legal value, that he could not accurately trace the family trusts in the U.S.. All of these serious lapses and acts place the Canadian tax base in peril. The Liberal majority closes its eyes and still makes no mention of them in its report.
- Finally, on May 16, 1996, the Deputy Minister of Revenue indicated to the Public Accounts Committee that throughout the month of December 1991 he was aware of a debate over the advance income tax ruling of December 23, 1991. However, in his October 2, 1996 testimony before the same committee, the deputy minister indicated to us that he was only informed on December 20, 1991. Coincidentally, the version given on October 2, 1996 corresponded much better with the justification of the famous briefing note of December 22, 1991, which was tabled in committee that same day. Once again, the Liberals deliberately omitted this important detail in their report.

The only thing that is beginning to enlighten Canadians about the family trusts scandal is not what is not found in the Liberal MPs' report, but rather what has been intentionally omitted.

Government manipulation

Numerous other examples make the list of inconsistencies, inexactitudes, lapses and differing versions even longer. From the outset of the Committee's work, the Liberal majority, blatantly manipulated by the government, prevented the Public Accounts Committee from shedding light on the entire family trusts scandal.

The majority report is the crowning achievement in this blatant effort by the government to bury this scandal and to silence the truth in order to protect themselves. The government is trying in every possible way to prevent Canadians from knowing the whole truth about these fiscal and financial manoeuvres which have probably cost the Canadian tax system billions of dollars.

The Bloc Québécois MPs also question the attitude of the Deputy Minister of Finance, David Dodge, who in verbally attacking the Auditor General during the Committee's last meeting, overstepped all rules of respect. His unacceptable and disrespectful behaviour demonstrates the government's arrogance towards one of our parliamentary system's most important institutions.

Recommendation

It is shameful and, unfortunately for the government, it is far from over. That is why with this dissenting opinion we, the Members of the Bloc Québécois, make the following recommendation:

That a special commission of inquiry be set up, independent of the government, with the mandate to shed light on all of the events surrounding the December 23, 1991 decision and the subsequent use of this tax loophole by other rich Canadian families.

Conclusion

Without an impartial and independent inquiry into all Liberal government partisanship, this scandal will never be brought to light. And if the government has nothing to hide, no one to protect and nothing to reproach itself as it pretends, what is preventing it from setting up such a commission of inquiry which would certainly clear it of any blame. At least, that's what the government has been repeatedly telling us for six months!

Michel Guimond, M.P.
Yves Rocheleau, M.P.
Pierre de Savoye, M.P.

Reform Party Dissenting Opinion to the Standing Committee on Public Accounts

Thursday, 24 October 1996

Respectfully submitted by:

Jim Silye, M.P.
John Williams, M.P.

The Reform Party of Canada files this dissenting minority report with reluctance. It was hoped that after the review and questioning of witnesses on Chapter 1 of the May 1996 Auditor General's Report, Committee members would reach a consensus and file a unanimous report. Unfortunately, all three parties drew different conclusions.

The Auditor General raised the issues of emigrant taxation of taxable Canadian property when exiting Canada and the advance tax ruling process in his audit of May 1996.

The majority report is fair in its comments concerning the steps taken by the Department of Finance to clarify the existing ambiguous tax legislation on emigrant taxation and closing the loopholes on the taxation of Canadian property upon the departure of a taxpayer from Canada.

However, when it came to critiquing what happened in 1991, the majority report fails or neglects certain facts and, thereby, draws very different conclusions than ours.

Under the section, Documentation, the report expresses concern about the lack of documentation but does not explain why. The paper trail in Revenue Canada was clear and ample, up to, but not including, the meetings of December 23, 1991, the day the final decision was rendered. No notes were made of several meetings that took place that day.

This final decision was a reversal of all the opinions documented prior to December 23, 1991, which clearly showed that Revenue Canada was opposed to a ruling in the taxpayer's favour.

Memoranda of December 18, 1991, and December 20, 1991, written by senior officials to the Deputy Minister of National Revenue advised him that the Department was unable to rule favourably. In fact, even the Revenue Canada Rulings Review Committee on December 12, 1991, decided that a favourable ruling should not be provided.

Due to the lack of minutes for the December 23, 1991, meetings where Finance and Justice apparently were able to resolve the policy issue and the legal issues, there is no evidence of contrary arguments considered and there is no bridging of the recommendations reached up to that date to provide an unfavourable ruling with other

analysis and documentation. The Auditor General had serious concerns that the tax ruling on the transaction may have circumvented the intent of the law.

Furthermore, the evidence shows that to put the transaction “on side”, Revenue Canada issued the favourable ruling upon the condition that the taxpayer provide a waiver and an undertaking not to invoke the tax treaty between Canada and the United States. This clearly shows that revenue Canada up to December 23, 1991, was correct in believing that the transactions intended to circumvent the law’s intent. But what happened on December 23, 1991???

The Auditor General also raised the question: in light of the fact that the taxpayer had already completed part of the transaction, did the department officials violate policy on advance income tax rulings? Once a transaction is completed, Revenue Canada cannot give an advance ruling — because what’s done is done.

The majority report tries to absolve department officials on the grounds of ambiguous legislation. Department officials claim that they were looking at proposed transactions. However, department officials admitted that an agreement was made with the taxpayer to bring the transaction “on side”, in other words, re-working the transaction supported by a waiver and an undertaking by the taxpayer. This side agreement to the ruling only goes to prove that, in fact, the transaction had been completed and, therefore, it appears that an advance tax ruling was inappropriate and in violation of department policy, and should not have been given.

This ruling was a mistake on the part of department officials and unfair to subsequent taxpayers, particularly in light of the fact that the tax ruling was not made public for many years. Consequently, other taxpayers were denied knowledge of the department’s actions and the benefit available to those who received the ruling. When the ruling was published, the requirement of the waiver and undertaking was withheld.

In our criticism of the department’s handling of this incident, we are in no way imputing motive or questioning the integrity of the officials involved nor of any impropriety on the part of any official in making this ruling, but we do believe they erred in their final decision and that the decision-making process was flawed.

We believe that Revenue Canada, in consultation with the Department of Finance and the Department of Justice, should have informed the taxpayer that the ruling requested was not possible because the disposing trust had not been a resident of Canada for ten years prior to the disposition; therefore, the capital gains were taxable when the asset was transferred to another country.

We believe that Revenue Canada should not have ruled favourably in this case due to the fact that an undertaking and a waiver were required and made a condition of the ruling. Revenue officials knew the waiver was not enforceable. The side agreement is a contingent liability for future advance rulings because future taxpayers may demand the same arrangements based on precedent.

The real issue is the integrity and fairness of the tax system and, in this instance, department officials responsible for the final decision should be criticized for the following:

- 1) the lack of documentation or minutes of the final meeting of December 23, 1991, to bridge all the discussions and opinions that led to the final ruling;

- 2) the need for a side agreement to legitimize and/or qualify the asset in the trust as taxable Canadian property which in hindsight gives the appearance of retroactivity;
- 3) the failure to publish for the public the advance tax ruling in a timely fashion, and;
- 4) when it was published, the failure to mention that it had been made on condition that the taxpayer provide an undertaking and a waiver.

These factors are enough to raise concern that a special agreement between Revenue Canada and a taxpayer may allow department officials to inadvertently weaken the tax base and violate the basic principle that the right to tax or not to tax rests with Parliament.

In conclusion, we do not agree that the Auditor General's concerns have been fully addressed. The Government has clarified the legislation and removed the ambiguities through a Ways and Means Motion in the House of Commons, despite the Government's reluctance to examine what happened in 1991.

Ultimately, we must thank the Auditor General for drawing this matter to Parliament's attention — otherwise this clarification of the treatment of taxable Canadian property leaving the country may never have happened.

Supplementary Opinion to the Report of the Standing Committee on Public Accounts

I fully concur in the Committee's report, and I would like to begin this supplementary opinion by congratulating the Minister of Finance on having taken the necessary steps to clarify the tax rules governing transfers of assets and property outside Canada.

It is important to note that the events (the advance ruling) that were the subject of review by the Auditor General occurred on and about December 23, 1991, when the previous government, the Conservative government, was in power.

I have frequently praised the quality of the Auditor General's work, and the report of the Committee underlines its excellence, but I think it is important to reiterate our congratulations.

Both the individual and the Office he represents deserve our respect and consideration as the elected represent of the people.

The integrity of our tax system is vitally important, and in that regard I must pay tribute to Revenue Canada's open approach. In its taxpayer information circular entitled "Revenue Canada — The Rulings Directorate Service", the Department says,

"The Office of the Auditor General of Canada regularly examines the Directorate's work including the advance rulings and technical interpretations that it issues."

The role of the Public Accounts Committee as I see it is, among other things, to give Canadian taxpayers the opportunity to have their elected representatives review the financial administration and management of the various government departments and agencies. The Committee is a forum where senior officials and managers have to account for their stewardship of public funds.

The matter we have dealt with here concerns taxation of capital gains when a taxpayer decides to leave Canada and live elsewhere.

In this case, the vehicle used to transfer assets was a family trust, but it could have been something else. It is not the vehicle we should focus on but the taxation of Canadian capital gains in the event of emigration.

The present case does however highlight two points that merit analysis in light of the ordinary taxpayer's perception:

1. The government has an obligation to continue to be open and transparent in all its dealings; in this regard I want to congratulate all my colleagues on the Public Accounts Committee.
2. The popular perception is that the gap between the richest and the poorest in our society must be reduced.

In the present case, the use of a family trust as the transfer vehicle tends to accentuate rather than minimize the gap, even though legally family trusts are open to anyone.

In conclusion, in addition to supporting the conclusions of the majority report, I hope that the government and the Department of Finance will put forward a genuine proposal for reform of Canada's tax system, both as it affects individuals, organizations and corporations and from a technical standpoint.

Respectfully submitted,

Denis Paradis
MP for Brome–Missisquoi and
Vice Chair of the Public Accounts Committee

REPORTS TO THE HOUSE

Monday, 10 February 1997

The Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

Pursuant to Standing Order 108(3)(d), your Committee considered Chapter 11 of the Report of the Auditor General of May 1996 (Revenue Canada — Combatting Income Tax Avoidance). Two meetings were held on this subject with representatives of Revenue Canada and the Office of the Auditor General, on June 12 and November 6, 1996.

Introduction

For several years now, the Public Accounts Committee has taken a special interest in issues involving Revenue Canada. For one thing, the Department underwent a number of major changes with the implementation of the GST and administrative consolidation of the former Departments of Customs and Excise and Taxation. For another, it has had to make an extra effort to retain the public's confidence in the income tax and GST collection system. It has stepped up its efforts to combat the underground economy and it has tried to increase the effectiveness of existing programs.

The Committee recognizes that these changes have put a great deal of pressure on departmental resources. However, it is important that Revenue Canada make sure that these resources are directed in a way that reflects its new priorities. The Department has taken a number of steps to improve existing programs. Over the past few years it has frequently responded positively to observations made by the Auditor General in his audits. In the spring of 1995, the Committee began consideration of Revenue Canada's collection, audit and special investigations programs. During the Committee's meetings with them, departmental representatives said that the Department already had a strategy that it planned to implement the following year. The Committee said in the report it tabled on these issues that it supported the Department in this endeavour but that it intended to follow developments closely. It is in this perspective that the Public Accounts Committee decided to report on the Tax Avoidance Program.

Background

Through its various audit programs, Revenue Canada seeks to enhance compliance with the legislation it must apply. Tax avoidance occurs when an operation that generates a tax advantage is contrary to the object or spirit of the law. It differs from tax evasion in that it does not consist in deliberately concealing income or falsifying expenditures.

The Tax Avoidance Program was designed to discourage abusive tax avoidance practices. Its main activities involve detecting and examining suspected abusive tax avoidance schemes and developing policies and procedures to counter them. In 1995-96, 139 full-time equivalents (FTEs) were working for the Tax Avoidance Program, and this number will rise to 160 over the next few years. Again in 1995-96, this group of auditors generated approximately \$365 million in reassessments, and Revenue Canada expects the amount generated to climb to \$500 million over the next few years.

These figures speak for themselves. Obviously the Public Accounts Committee has no desire to question the value of the Tax Avoidance Program. However, it must be ensured that the auditors who work for it have tools that function adequately. Tax legislation is the first tool they use in making reassessments. Another essential tool is cooperation with other parties involved in tax avoidance matters: this may entail cooperation with other sectors within the Department (Large Business or Appeals, for example) or with other departments (Finance or Justice, for example). The Committee believes that improvements could be made to the Program that would increase the effectiveness of these tools.

Cooperation and Communication

Until recently, when a tax avoidance auditor began to investigate a given file it was because a front-line tax auditor had decided to refer that file to him or her. In practice, few cases were referred to the tax avoidance auditors. The figures indicate that tax auditors of large businesses referred only 27 cases to the Tax Avoidance Division in 1994-95, and only one to the Toronto office. Moreover, referral practices are not necessarily uniform among the various district offices, which does not promote fairness. The Committee is not confident that a file would be handled the same way everywhere in Canada. At the meeting of November 6, 1996, the Assistant Deputy Minister, Mr. Barry Lacombe, said that he had not been very happy with the handling of the one Toronto tax avoidance referral. He considers, however, that the problem is unlikely to arise again given the new approach to large business audits: tax avoidance auditors will be an integral part of the large business audit team. The Committee regards this as a step in the right direction, facilitating cooperation between the large business tax auditors and the tax avoidance auditors. However, the Committee considers that it remains to be seen whether the new approach will be successful. The Committee has not been given many details on the way in which the expertise of the tax avoidance specialists will be used. It would also like to know how the new approach will encourage standardized case handling by different district offices. Accordingly your Committee recommends:

That, as soon as data are available for the 1996-97 fiscal year, the Department produce a report on the new approach incorporating tax avoidance auditors into large business tax audit teams. The report should compare the number of referrals made by each district office in 1996-97 with the number made in preceding years. The report should also show how the new approach has succeeded in encouraging standardized application of the rules governing large business tax audits.

The Committee also noted that the tax avoidance specialists were not getting enough feedback about changes by other sections to reassessments they had made. For example, assessments can be the subject of a notice of objection, and notices of objection are handled by the Department's Appeals Branch. According to the Auditor General, when assessments are changed the results of the procedure are not always communicated to the people who had worked on the file previously. The Committee considers that it would be helpful for tax avoidance auditors to be informed of the reasons for a change, so that they can be better prepared to identify situations that may lead to an appeal.

The Committee also found that there was a lack of communication regarding rulings handed down by the interdepartmental committee that reviews and approves every application of the General Anti-Avoidance Rule. Like the Appeals Branch, the interdepartmental committee does not systematically give the specialists the feedback they need on its rulings. During the meeting, Mr. Lacombe attempted to reassure the Public Accounts Committee about the problem of communication, noting a number of initiatives that had been implemented. For instance, Revenue Canada now issues a quarterly report to its tax avoidance auditors on all Interdepartmental Committee activities. Measures have been taken to ensure that anything that happens at the Appeals level is fed back to the auditors as well. Mr. Lacombe also said that Revenue Canada had set up a task force on communications. The Department is now working to implement the recommendations made by the task force. It should be noted that the Deputy Auditor General, Mr. Minto, said he was very encouraged by the Department's efforts. The Committee shares his positive reaction, but it still wishes to follow closely the Department's efforts in the area of communication. Accordingly your Committee recommends:

That, as soon as the data become available for the 1996-97 fiscal year, the Department produce a report on the initiatives it announced with respect to communication among its various sections. The report should indicate the extent to which the recommendations of the task force on communications have been implemented.

Legislative Changes

A. Abusive Tax Shelters

The legislation permits a taxpayer to deduct the losses arising from a tax shelter up to the amount invested or at risk. An abusive tax shelter is one that is set up so that taxpayers can deduct losses that exceed the amount at risk, or overvalue the underlying asset. The Committee found that, until very recently, abusive tax shelters have been the rule rather than the exception: of some 325 tax shelters audited between 1993 and 1995, Revenue Canada found that most were abusive.

Revenue Canada has taken steps to uncover such abuses and deal with them. For example, new rules have been adopted governing at-risk amounts, so that taxpayers cannot deduct losses worth more than the amounts they have put at risk by their investments. The Department has also introduced a new system of film tax credits. The Committee applauds these initiatives, but wonders whether the Department could not go further. During the meeting of November 6, 1996, the Committee asked the departmental representatives what Revenue Canada's reaction would be to the Auditor General's idea of imposing penalties on promoters of abusive tax shelters. In his report, the Auditor General commented that promoters of abusive tax shelters run almost no risks in Canada, whereas in the United States they can be charged and statutory penalties imposed.

The Committee was glad to learn that Mr. Lacombe supports the Auditor General's recommendation, which he regards as a necessary measure. Mr. Lacombe said that Revenue Canada was at that time discussing the possibility with the Department of Finance. However, he could not give a precise date when the discussions would conclude. The Committee considers that this matter should be a priority for the Department, and that it should act in consequence. Accordingly your Committee recommends:

That Revenue Canada and the Department of Finance take prompt steps to introduce penalties for promoters of abusive tax shelters.

B. Hardship Waivers

Another point raised by the Committee was that of hardship waivers in cases of abusive tax shelters. Revenue Canada can reduce the at-source deductions of taxpayers who have invested in tax shelters if they can prove that the deductions exceed the income tax payable at year-end. People buying into tax shelters are encouraged by the promoters to request a hardship waiver because it then becomes possible to finance the cash portion of the purchase out of the reduction in at-source deductions.

A request for a hardship waiver will be rejected only if the shelter is being audited at the time. Given that the Department's records show that most tax shelters have been found to be abusive, the Committee wonders whether the procedure for granting hardship waivers should not be rethought. The Committee understands the idea behind the waivers, but it considers that the limits on granting them are imprecise, especially where tax shelters are involved. Mr. Lacombe said that the Department was going to look into at-source deductions and propose changes if these were to prove necessary. The Committee considers that the Department could go further. Accordingly your Committee recommends:

That Revenue Canada initiate without delay an examination of the issue of at-source deductions, so that the Department will be in a position to inform the Committee, in its overall response to this Report, of any changes it proposes to make.

Interest Waivers

Since 1991, Revenue Canada has had discretionary power to waive or cancel all or part of interest and penalties assessed for the 1985 and subsequent tax years. During its consideration of the chapter on income tax debt collection in February 1995, the Committee was concerned about the fact that the Department could not determine the total value of reassessments made since 1991 under the Fairness Package. The amount of interest waived under the Fairness Package was nowhere apparent. In its response to the Committee's Eighth Report (1st Session), the Department said it would be presenting a report giving the cumulative total of interest and penalties forgiven under the Fairness Package, as well as a breakdown by reason for the waiver. The official publication of these data in the Public Accounts of Canada is scheduled to begin in 1996-97.

The Committee wants to make sure that the Department includes all relevant data in its report. The Committee learned that the new on-line system to identify cumulative interest can only indicate the amount of interest that has been cancelled by the Appeals Branch, and not the amount waived when a file is subject to audit. The Committee considers it important to know the real amount the Department is foregoing. Mr. Lacombe told the Committee that changes would be made to the system so that it can also produce figures for waived interest that does not appear in the accounting record. He thought the system for handling interest that has been waived should be in place in a year's time. He also said that cancelled and waived interest would be included in the Department's performance report to Parliament. Accordingly your Committee recommends:

That Revenue Canada step up its efforts to make the necessary changes to its systems, so that both cancelled interest and interest not appearing in the accounting record can be included in the Department's next performance report, in the autumn of 1997.

The Underground Economy

Although the issue of the underground economy was not specifically dealt with by the Auditor General in this chapter, the Committee would like to comment on it. First, the Committee considers that intense vigilance is required in dealing with the underground economy, because the battle is far from won. If underground transactions are not firmly opposed, they may undermine voluntary compliance. The Committee considers that the Department should continue its efforts to publicize fraud convictions widely. The Department should also try to improve its detection techniques still further, since taxpayers are finding more and more subtle ways of getting around the law. Second, the Committee shares the widely-held sentiment that the more complicated a tax is, the less willing people are to pay it. That is why the Committee urges Revenue Canada look actively for ways to simplify the administration of the tax legislation.

The Committee observed that the Department has made the fight against the underground economy one of its priorities, as evidenced by the fact that the resources assigned to this program will go from 1,200 FTEs to 2,000 FTEs by 1998-99. The Department estimates that this initiative will bring in net revenues of about \$100 million a year. The Committee does not question the decision to assign additional resources to the program, but it would like the initiative to be reviewed from time to time to ensure that these resources would not be more valuable elsewhere. The Committee is eager to see the conclusions arising out of the evaluation of the underground economy program that the Department is carrying out in 1996-97.

Pursuant to Standing Order 109, your Committee requests the government to table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issues nos. 1, 2 and 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

REPORTS TO THE HOUSE

Monday, 7 April 1997

The Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

Pursuant to Standing Order 108(3)(d), your Committee considered Chapter 14 of the Report of the Auditor General of September 1996 (Service Quality). One meeting was held on this subject with representatives of Treasury Board Secretariat, Human Resources Development Canada, and the Office of the Auditor General, on 5 November 1996.

Introduction

Canadians pay for and receive a wide variety of services from their federal government. These services include issuing passports, answering tax inquiries, and processing claims for employment insurance. The audit reported in chapter 14 of the Auditor General's September 1996 Report examined 13 important services that are delivered directly to the public.

It is of great importance that services delivered by government be of the highest possible quality. These services often correspond to very fundamental needs, especially when they concern social security. In addition, for many, the process of receiving a service is the principal form of contact between them and their federal government. It is through this experience that they form their views of government as an institution. The quality of the service they receive is, therefore, an important determining factor in shaping opinions about government as a whole. In this respect, concern about the quality of this service goes beyond issues of great importance to individuals and touches upon confidence in our governing institutions. For all of these reasons, the quality of the services being delivered is an issue that should rank among the leading priorities of public servants and elected representatives alike.

In order to explore the quality of services delivered directly to Canadians by the federal government, the Committee met with Assistant Auditor General Maria Barrados, Secretary of Treasury Board Secretariat Peter Harder, and Mr. Hy Braiter and Mr. David Good of the Department of Human Resources Development on 5 November 1996.

Service Standards

One of the most effective ways to improve the quality of services is through implementation of service standards for such factors as timeliness, accessibility, reliability and accuracy of service. These standards — if developed in consultation with clients and public service providers — promise not only to improve services, but to enhance accountability and transparency. The performance of those providing services can be assessed against these standards and recipients will know what they can reasonably expect. Furthermore, the process of developing standards in consultation with recipients should help government assign priorities to the services it provides. This in turn should facilitate elimination of services for which there is little need or demand. Services that are retained can then be better targeted to address actual needs. From this perspective, developing and implementing service standards should be viewed as an integral part of the strategy to control costs and get government right.

The need for service standards is recognized within government. Unfortunately this need has not yet been fully realized.

Beginning in December 1990, government has made repeated commitments to establishing clear standards for the services it delivers. Often, these commitments have included setting target dates for full implementation of these standards. One of the more recent expressions of this commitment is found in Part I of the Estimates for 1995-96 and states that “departments will have service standards in place for their major services by the end of 1996.”

The Committee discovered that these expectations have not been met. In his Report the Auditor General indicates that, as of 31 March 1996, “none of the 13 services [audited] had published service standards that contained all of the required elements.” (14:29) Based on this, as well as other, observations, the Auditor General concludes that “government expectations have not been realized” with regard to the implementation of service standards. Between completion of the audit, the release of its findings in September, and the Committee’s meeting with witnesses on 5 November 1996, little had changed. As Maria Barrados, Assistant Auditor General, told us in her opening statement, “[o]verall, the government’s progress in implementing service standards has been slow and its achievement uneven. Implementation target dates have not been met.” (30:2)

During our discussion with witnesses, we endeavoured to find out why these expectations and commitments have not been met. Mr. Harder, Secretary of the Treasury Board and Comptroller General of Canada, told us that quality service “is a complex process” that “often takes five to seven years to accomplish.”(30:4) The responsibility for implementing service standards and the quality services initiative, he emphasized, “lies with departments.”(30:3) At another point in his testimony, he suggested that Parliament assume some of the responsibility, indicating that members of the Committee and “your colleagues in other committees would be very helpful ... if you asked where these various departments are on service standards, where their quality service plans are.” (30:16) For his part, Mr. Braiter, of Human Resources Development Canada, agreed that it takes a long time to implement service standards, and stated that the biggest constraint involved was an attitudinal one — “making sure everybody really believes that the reason they are civil servants and public servants is to serve the public.” (30:20) Mr. Braiter also stated that leadership was something “which we have lots of.” (30:20). Yet, despite the claim of plentiful leadership and the passage of seven years — the outer limit identified by Mr. Harder as the amount of time needed to complete such exercises — the Auditor General reports that the results are incomplete and disappointing.

When the federal government first embarked on the Service Standards Initiative in 1990 (now part of the Quality Services Initiative), the President of Treasury Board was given the overall responsibility for the initiative. At least initially, the Secretary of Treasury Board “took a lead role in developing guidance, requesting progress reports and co-ordinating interdepartmental networks and committees” engaged in the service standards initiative. (14:22) Apparently, all of this has changed. Now, it is the departments’ responsibility alone — with prodding from parliamentary committees — to ensure that standards will be developed for the services they provide.

Mr. Harder was asked to follow the example set by his predecessors and indicate when he expected all departments to have service standards in place. The Committee sought an answer to this question for two fundamental reasons. A commitment to a completion date constitutes an essential element in the accountability framework needed to ensure successful implementation of this initiative. Setting this date would send a clear message to the departments emphasizing the priority which the government assigns to this issue and the expectations flowing from that priority. Furthermore, by identifying a date, the Secretary of Treasury Board would confirm his department’s leadership role in providing an implementation and accountability framework. Lastly, had he given a positive answer to the Committee’s question, Mr. Harder would have given a commitment against which he and Treasury Board Secretariat could also have been held accountable.

Yet given this opportunity, Mr. Harder chose to tell the Committee:

I don't want to give a date so you or your successor can say, "You were here last week or last month and said the Government of Canada would be able to do it by x date," when in fact it has to be done by the departments that are delivering service changes. I don't think it would be helpful to have an artificial date. (30:33)

Mr. Harder gave this answer in spite of his recognition that previous efforts to set implantation targets were "an attempt by the people who were leading this to provide an incentive and a level of encouragement to departments and signal the seriousness with which quality service is being focused on." (30:33) Apparently, this is an incentive he will not give, a signal that he will not send. In his opinion, the previous dates that were established, were "artificial." Mr. Harder's refusal to name a completion date was all the more surprising in light of his assertion that "many federal departments have introduced service standards" and are "now beginning to publish these standards." (30:3) If one accepts the accuracy of this statement, how difficult should it be to identify the point at which the exercise will be finished and standards in place for all departments?

Mr. Harder's comments appear to suggest that neither he nor Treasury Board Secretariat want to dictate to departments what they must do. But leadership also consists of other measures. It also consists of making clear statements of expectations and setting an example by accepting a measure of responsibility for outcomes that are achieved. What are departments to make of it when the Secretary of Treasury Board declines to do either one of these things? Clearly, if this initiative is not to be sidelined, as the Auditor General fears it might, Treasury Board Secretariat must accept its responsibility and move the process forward. To accomplish this, Treasury Board Secretariat must provide an implementation framework, must co-ordinate this effort throughout government and must offer departments the guidance and incentives for ensuring that they succeed. The Committee therefore recommends:

That Treasury Board Secretariat develop and make public its implementation framework for the Quality Services Initiative by 30 September 1997. Particular reference must be made to achieving service standards within the context of the Initiative.

Furthermore, we recommend:

That Treasury Board Secretariat lead the Quality Services Initiative by establishing, in co-operation with the departments, a final target completion date for the entire initiative, and by providing guidance and incentives to the departments to ensure that this initiative is completed successfully.

We also recommend:

That by 30 September 1997 Treasury Board Secretariat make public the target implementation date for the Quality Services Initiative.

Measuring performance against expectations is a key element in an accountability relationship. If departments are going to set standards for the services they provide, they must develop implementation plans that include target completion dates; otherwise, the process threatens to drag out forever. Once these plans and targets have been established, departments can be held accountable for achieving them.

It is important not to underestimate the difficulties involved in developing service standards and setting dates for implementing them. But although the exercise is difficult, it is not impossible. The Committee was pleased to note that Human Resources Development Canada — a department that is more heavily involved than most in

delivering services to Canadians — showed no reluctance in naming the date by which it expected to have its service standards developed and published. Mr. Good told us that it is his department's "commitment and intent" to have the standards published by 1997-98, following consultation with its clients. If this department can take this step, others should be capable of doing the same. We therefore strongly recommend:

That all departments delivering services directly to Canadians establish plans for implementing the Quality Services Initiative. These plans must include a timetable for full implementation, including target dates for publication of service standards, and must be made available to Parliament and the public.

In his report, the Auditor General stressed that in order to be effective, service standards should be developed in consultation with those receiving the services. While it would be unrealistic to expect that all client preferences will be met, they must be taken into account if a balance is to be achieved between what is needed and what can be provided. The Committee was thus troubled to learn that in those instances in which standards had been developed, little consultation with clients had taken place. This is of particular concern when departments adopt technological approaches to service delivery in order to save money. For example, reliance on touch-tone phone services may create substantial barriers for senior citizens, or for those who prefer to deal with human beings rather than machines. In addition, efforts to reduce costs by consolidating services in single locations may move these services beyond the reach of those who truly need them. These are drawbacks that might be avoided if careful consultations with clients had been conducted before hand. We therefore recommend:

That departments, as an integral part of establishing standards for the services they provide, consult those receiving services and take their needs into account before final implementation occurs.

Mr. Harder indicated that standing committees of the House of Commons have a role to play in ensuring that the quality services initiative succeeds. If Standing Committees are to do this, they must have appropriate information on departmental service standards. Recently, under the guidance of Treasury Board Secretariat, several departments and agencies have begun to produce pilot performance documents that have been tabled in the fall and referred to the appropriate standing committees. Apart from these pilot documents, departments regularly include statements regarding past performance in part III of their Estimates. In order to give departmental progress in setting and meeting service standards the profile it deserves, this information should be made available to Parliament through either one of these vehicles. Accordingly, we recommend:

That departments make public the standards they have established for the services they deliver to Canadians and report performance against these standards in either Part III of their Estimates, or, when appropriate, in performance reports tabled in the House of Commons in the fall.

In closing, we note Ms. Barrados' observation in her opening statement that "little information has been provided by Treasury Board Secretariat to Parliament to indicate clearly the progress in the implementation of service standards." (30:3) In order to rectify this shortcoming, we recommend:

That Treasury Board Secretariat report annually to Parliament on the progress being made in the development and implementation of service standards throughout government, either in Part III of its Estimates, in its performance report, or in a separate document designated for this purpose.

Telephone Services

Because the telephone has become the most common method used by Canadians to communicate with government, the Auditor General focused particular attention on the telephone operations of six of the 13 services that were examined. The results reported are not encouraging.

Despite variations, callers generally had difficulty in getting through to call centres. Callers often encounter busy signals or are put on hold; many abandon their attempt and hang up. When calls are answered, the accuracy of the information provided is sometimes in doubt. Most of the audited departments did not assess the quality of information being provided by their phone services. The one instance in which verification did take place, the results were particularly discouraging. The Committee was particularly dismayed to discover that according to the Auditor General, Revenue Canada's Taxation branch's rate of accuracy of answers "has varied between 61 and 79 percent in the last few years." (14.57) Since calls often involve efforts to obtain information about vital government services, long waits and inaccurate answers are simply not acceptable.

In response to these problems, actions taken by the departments involved seems scarcely adequate. Although some have established internal accessibility targets, none have published service standards that would give clients an idea of how long they can reasonably be expected to wait for calls to be answered. The quality of telephone contacts is not regularly monitored and, with the exception of Taxation and Statistics Canada, none of the services had set targets for the accuracy of answers to their clients. Finally, little effort has been made to collect and analyse the nature of clients' calls and complaints.

In order to correct these deficiencies, the Committee recommends:

That departments with telephone services publish service standards governing accessibility and accuracy of answers, that they collect and analyse client complaints about telephone services, and that they regularly measure and publicly report performance against the standards they have established.

Direct Deposit

During our meeting with witnesses we discovered that many of the inquiries received by departmental telephone services concerned the status of cheques sent out to clients. One way of reducing these enquiries — and thus the burden placed on phone centres — would be to have more of these cheques deposited directly into recipients' bank accounts. Other benefits include reduced costs to government (in terms of postage, envelopes, handling, etc.) and enhanced security for senior recipients.

Considerable progress has already been achieved in enhancing the use of direct deposits. Public Works and Government Services Canada is leading a government-wide initiative to promote the use of direct deposit and the number of such deposits has grown from 5 million in 1991 to 74 million in 1995-96. The Committee learned that Old Age Security, the Canada Pension Plan and the Child Tax Benefit now have direct deposit enrolment rates of 63.8 percent, 60 percent and 48.2 percent respectively as of 31 March 1996.

The Committee recognizes that efforts to increase the numbers of direct deposits may encounter certain limitations. For example, our witnesses pointed out that some recipients are either transient, do not have permanent bank accounts, or both. However, while we acknowledge that the level of direct deposit can not be brought to 100

percent, we do think that departments must continue efforts to expand this practice to the fullest extent possible. The Committee therefore recommends:

That departments engaged in paying benefits continue with efforts to enhance the use of direct deposits as the principal means of payment.

Conclusion

As Members of the House of Commons Standing Committee on Public Accounts, we are concerned that government achieves maximum value in exchange for the moneys it receives through taxes and other fees paid by Canadians. We are also concerned that those who are entrusted with public funds be held accountable for their prudent use in accordance with policies adopted by Parliament.

As individual Members of the House of Commons, we are also deeply concerned with the well-being of our constituents. For us, the notion of providing good service to Canadians extends well beyond a simple theoretical issue. Instead, this is a matter that is of fundamental importance in the day-to-day lives of many of those whom we represent.

The results reported by the Auditor General in this chapter of the September 1996 report therefore deeply concern us at both levels. It is evident that since improvements to service delivery are not being pursued with sufficient rigour, opportunities to reduce costs while tailoring programs to meet actual needs are being lost. It is also evident — and we know this through daily contact with those whom we serve — that the needs of individual citizens are not being fully met. Neither situation is tolerable.

We therefore call upon government to act promptly on both our recommendations and those made by the Auditor General of Canada. Through sustained effort and sufficient will, government should be able to provide Canadians with services that are of the highest quality possible in accordance with standards that are reasonable and public. In light of the taxes they pay and the need that exists, Canadians should not be required to wait any longer.

Pursuant to Standing Order 109, your Committee requests the government to table a comprehensive response to this Report.

The supplementary opinion of Denis Paradis is appended to this Report.

A copy of the relevant *Minutes of Proceedings (Issues nos. 2 and 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

Denis Paradis
MP Brome–Missisquoi
Vice–Chairman of the Standing Committee on Public Accounts

**Supplementary Opinion to the Report of
the Standing Committee on Public Accounts
Wednesday, March 19th, 1997**

Direct Deposit

For salary purposes

Direct deposit is an appropriate payment method for those who receive salaries from the federal government. The system is practical and economical for the stable, regular salaries paid by the government to its employees.

Prevention of fraud

However, for payments made under specific government programs, such as employment insurance and family allowances, the use of direct deposit is likely to require a degree of saintliness among recipients that is beyond the reach of the average citizen. If the money is deposited automatically and regularly in a recipient's bank account, the recipient may well not feel a sense of urgency about informing the payor that the conditions of his or her status or availability have changed, whether temporarily or permanently.

Conversely, payment by means of a cheque forces the recipient to take definite action (to endorse or deposit the cheque), and this may prevent cases of abuse or fraud.

For example, although our employment insurance system requires recipients to be available for work in Canada, it is relatively easy to go to Florida with the direct deposit system, while endorsing and depositing a cheque is likely to require a local presence.

The visibility of government

At a time when we are trying to develop a feeling of Canadian pride, one issue must be raised concerning the significance of government visibility when a payment is made to a recipient. Those receiving employment insurance benefits or a family allowance should receive a real cheque from the government rather than using the direct deposit system.

In conclusion, direct deposit has the effect of distancing citizens from their government.

Respectfully submitted,

Denis Paradis, MP
Brome-Missisquoi

REPORTS TO THE HOUSE

Monday, 14 April 1997

The Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 26 of the November 1996 Report of the Auditor General (Canada Infrastructure Works Program — Lessons Learned). The Committee held a meeting on this subject on February 20, 1997 with representatives of the Office of the Auditor General, the Canada Infrastructure Works Office, the Treasury Board Secretariat and the Federal Office of Regional Development (Quebec).

Introduction

The Canada Infrastructure Works Program was introduced by the federal government in 1994 as a temporary initiative, with a planned duration of five years. A series of federal-provincial agreements provides the framework for its implementation and assigns much of the authority for the day-to-day delivery to the provinces.

The cost of the program is shared. The federal government contributed approximately \$2 billion in program funds, with roughly a further \$4 billion provided by provincial governments and municipalities, along with other local sponsors. Federal funds were allocated to provinces, territories and First Nations based on their respective shares of population and unemployment, both of which were given equal weight.

The Auditor General's observations about the Canada Infrastructure Works Program are presented as lessons learned. The Committee is of the view that his observations come just at the right time, given the government's recent decision to extend the program. \$425 million will be added to the \$175 million expenditure that was planned for under the initial program. Along with the program evaluation conducted by Mr. Richard Soberman at the University of Toronto, published in September 1996, the Committee feels that the government now has two high-quality documents prepared by outside sources that will enable it to identify the program's strengths and weaknesses. At the meeting, the Committee's goal was in fact to find out what lessons the government had learned from the first phase of the program, and whether the government was planning to make changes in the second phase or in future programs of the same kind.

The Committee would also like to point out that the program has proven beneficial from a number of standpoints. First, the program was implemented rapidly, which was essential if its goal — that of accelerating national economic recovery by creating jobs — was to be achieved. Within a period of only eight weeks following the announcement of the program, the federal-provincial agreements were put in place, program frameworks were developed, guidelines established, and the program made operational. Second, existing expertise and competencies were considered, but all the stakeholders had some input. Program implementation focused on local identification of needs, community priority setting and local municipal decision-making about project selection. The projects selected were examined by the provinces and the federal government. Third, the 12,000 projects approved have contributed substantially to improved local infrastructures in Canada.

Early in the meeting, Mr. Paul Thibault, Executive Director of the Canada Infrastructure Works Program, told the Committee that he noted some discrepancy between the text of Chapter 26 which in total is rather positive

about the program, and the Main Points and the Auditor General's press release, which both concentrate almost entirely on the negative. After reviewing these documents, the Committee acknowledges that Mr. Thibault's dissatisfaction with the press release may well be justified.

Compliance audit

The success of the Canada Infrastructure Works Program (CIWP) will likely encourage the government to explore this new method of delivering service. The Committee would like to make a few comments on this point. The federal government was not responsible for day-to-day CIWP project management, which was left to the provinces and municipalities. This arrangement had the effect of avoiding overlap of functions and reducing overall administrative expenditures. The Committee is in agreement with these terms. However, Committee members feel it is important not to lose sight of the fact that Parliament must be certain that public funds are spent on the purpose for which they are intended. It is therefore important to know that program goals have been reached and that the conditions were met.

Since one may assume that the other levels of government also want to be sure of this, the Committee believes that any level of government could actually carry out the compliance audit. The federal government would only have to ensure that the criteria used in conducting the audit are acceptable.

In his report, the Auditor General noted that the agreements contained no specific requirements for timely compliance audits. Quebec has been relatively more effective in this regard, and has introduced a compliance audit system for a sampling of projects. The audits were to be completed before final payments were made, and penalties were provided for.

In its response at the end of Chapter 26, the government agreed with the conclusion that the requirement for a compliance audit plan should have been included in each of the agreements at the outset. The Committee was pleased to learn that the CIWP Office will be negotiating agreements on audit planning for the extended program. Therefore, the Committee recommends:

That the CIWP Office follow Quebec's example when negotiating agreements with its partners in order to put in place a compliance audit system. The Office should also ensure that the quality and coverage of the compliance audits meet the federal government's requirements for the program.

Additional or incremental investment

One program requirement concerned the generation of additional or accelerated investment. In other words, it was expected that the investment in infrastructure would be greater than it would have been if the program had not existed. Government funds were not to be invested in projects that would have been carried out in any case. The Committee noted that incremental investment is not easy to measure. Two factors must be understood: how much actually was spent by municipalities on infrastructure, and how much would have been spent had the program not existed. Because there is no exact way to determine municipalities' prior intentions, the measure of the level of incrementality is at best approximate. As Mr. Thibault said at the meeting, this is not an exact science.

In the Committee's view, it is nevertheless important to determine the extent to which the program has made a difference, even if it is only possible to come up with an estimate. The CIWP evaluation conducted by Mr. Richard Soberman states that this was not a priority objective in the decision-making process: "In terms of Program weaknesses, one relates to the level of incremental spending. Employment and other economic benefits are directly related to incrementality but, except for Quebec, there appears to have been little serious effort to enforce this

program requirement. Nation-wide, the level of incrementality cannot be determined with a high degree of certainty.” However, the study uses two assumed levels of incrementality for its economic evaluation — 100 per cent and 60 per cent. The author mentions that the level of 60 per cent appears to be more realistic than the level of 100 per cent.

For his part, the Auditor General estimated that, in 1994, 35 per cent of total expenditures replaced capital expenditures that would have been incurred in any case. The Auditor General, then, calculated the level of incrementality at 65 per cent. In its response at the end of the Chapter, the government stated that recent information from Statistics Canada on actual municipal capital investment supports the government’s analysis of a level of additional investment that was somewhat higher than the chapter’s estimates.

Faced with all these data, the Committee would like to make two observations. First, the Committee notes that the projects that did not generate incremental investment were probably not any less useful or necessary on that account. Clearly, almost all the projects resulted in local infrastructure enhancements and created jobs. However, the Committee is of the view that that the government must attempt to maximize the returns made on investments in this type of program. The Committee does not want to get into a war of numbers on what the program’s real level of incremental investment was, what it would have been otherwise, and what it should be now that the program has been extended. However, and this is the Committee’s second observation, efforts should be made to demonstrate more clearly that there is incremental investment.

In this regard, the Committee would like to highlight the innovative aspect of the approach used in the Canada–Quebec agreement to ensure incremental investment. The Ministry of Municipal Affairs calculated the minimum capital expenditure level for every municipality in Quebec. Mr. Guy MacKenzie, Assistant Deputy Minister in the Federal Office of Regional Development (Quebec), told the Committee that the minimum capital expenditure level was determined by taking the lowest result from the following three calculations: average capital expenditures for engineering in 1991 and 1992, and the average for municipalities of comparable size.

The Committee would like to mention that in his 1995-1996 report the Auditor General for Quebec mentioned a few points that raise concerns about the calculation of the minimum level. The method used can be improved, but the Committee believes that the basic idea is a good one. In the other provinces, most provisions for additional investment were applied to individual projects rather than to overall investment by municipalities. This situation can be problematic. For example, a new, improved project may hide a project abandoned because it would have been ineligible for CIWP assistance. If projects are simply replaced, overall investment by municipalities is not necessarily increased.

During the meeting, the Committee asked Mr. Thibault whether he planned to monitor the level of incremental investment more closely. Mr. Thibault answered in the affirmative. He went on to say: “. . . we now have an evaluation plan which we will implement for the first part of the program in an effort to deal with these questions in a better fashion and to provide you with more details the next time.”

The Committee is aware that calculating incremental investment on the basis of a minimum level will constitute a significant alteration in the agreements. We are therefore not expecting that it will be included in the current negotiations for the extended program. However, the Committee recommends:

That this component be taken into consideration in any similar infrastructure program in the future.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue No. 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

REPORTS TO THE HOUSE

Tuesday, 15 April 1997

The Standing Committee on Public Accounts has the honour to present its

SEVENTH REPORT

Pursuant to Standing Order 108(3)(d), your Committee has studied Chapter 23 of the November 1996 Report of the Auditor General (Materiel Management in the Federal Government).

I. INTRODUCTION

In the government of Canada, the term “materiel” refers to all moveable public property and all other assets other than money and real property. Costs associated with these assets are significant. Each year, federal government materiel purchases are quite large — for fiscal year 1994-95, for example, approximately \$8 billion was spent for this purpose. In addition, the estimated value of the government’s materiel holdings is considerable — approximately \$50 billion dollars. Of these holdings, materiel valued at between \$8 and \$10 billion is kept in warehouses, at an estimated carrying cost of between \$2 billion and \$2.5 billion annually.

In light of these costs, it is important that management of materiel assets — an activity which encompasses acquisition, use, and disposal — be conducted as effectively and efficiently as possible. In chapter 23 his Annual Report for 1996, however, the Auditor General of Canada informed Parliament that many of the deficiencies in the government’s materiel management practices identified in audits as far back as 1980 still exist. Although he reported that initiatives are under way to correct these deficiencies, he indicated that additional actions are required in order to ensure that they succeed.

As a consequence of the costs involved and the need to ensure that immediate steps are taken to produce more effective management of these assets, the Committee met with the Auditor General of Canada, Mr. Al Clayton, Executive Director, Bureau of Real Property and Materiel, Government Operations Sector, Treasury Board Secretariat, and Ms Louise Fréchette, Deputy Minister, Department of National Defence, on 11 and 12 February 1997.

II. OBSERVATIONS AND RECOMMENDATIONS

From the information contained in the Auditor General’s Report and testimony given by witnesses, the Committee learned that materiel management within the federal government constitutes a significant challenge. The audit report found that the departments and agencies examined often do not know how much materiel they hold in inventory, and where it is located. Roles and accountability relationships are unclear, and information systems established to track materiel holdings are quite often inadequate; this makes good materiel management very difficult.

The Policy and Management Framework for Materiel

A sound policy and management framework needs to be in place so that materiel holdings can be managed effectively and with due regard for economy. The Auditor General’s findings indicate that although these basic

structural elements are in place, they contain gaps which frustrate better management of these costly resources. Improvements are needed with respect to the role of Treasury Board Secretariat — the central agency responsible for monitoring materiel management practices throughout government — and at the departmental level where the principal responsibility for the day-to-day management of materiel resources lies.

The responsibility for providing leadership, direction and advice to departments on materiel management belongs to Treasury Board Secretariat. The Auditor General reports that the Secretariat has taken a number of initiatives to fulfil its role in this respect; an important aspect of this role, however, is not receiving the attention it deserves. According to its own policies on materiel management, Treasury Board Secretariat monitors — the implementation and effectiveness of Treasury Board’s materiel management policy. The audit reported, however, that the Bureau of Real Property and Materiel, the unit within the Secretariat that deals with materiel policy,

has access to departmental internal audit and program evaluation reports but does not monitor them systematically to identify problems with the materiel management policy or its implementation. (23.27)

According to the Auditor General, Treasury Board Secretariat officials explained that this systematic monitoring of departmental internal audits and program evaluations is not carried out

because the departmental reports do not provide information that [Secretariat officials] consider useful to address systemic issues...(23.27)

This assessment was confirmed by Mr. Clayton, Director of the Bureau of Real Property and Materiel, who told the Committee that departmental information systems “are not all that good.”(39:16) In his Report, the Auditor General concluded that Treasury Board Secretariat does not have all the information it needs to fulfil its responsibilities.

To further complicate matters, there appear to be different interpretations of what Treasury Board Secretariat’s role is or ought to be with respect to monitoring materiel management throughout government. While these interpretations may have varying degrees of accuracy and validity, they need to be resolved as part of the effort to improve government-wide materiel management. As things currently stand, the uncertainty surrounding Treasury Board Secretariat’s role prompted some members of the Committee to wonder whether the Secretariat’s involvement in materiel management was really needed. Others felt that perhaps the Secretariat should fulfil its mandate as described in its policies on a more proactive basis.

Two steps are needed to address problems in the policy and management framework for materiel management. Treasury Board Secretariat needs to clarify its role in this area — including its monitoring function — and to better align practice with policy. For their part, departments also need to clarify roles and responsibilities, and to put in place information systems that respond to Treasury Board Secretariat’s needs as well as their own. Accordingly, as a first step, we recommend:

That Treasury Board Secretariat review and clarify its role in government-wide materiel management, including the monitoring of departmental materiel management performance, and that it subsequently align its materiel management practices with policies.

Clarification and affirmation of the Secretariat’s role should be accomplished in a timely fashion so that departments can align their materiel practices with policies accordingly. We therefore recommend:

That Treasury Board Secretariat complete its review and report the results no later than 30 September 1997.

Once Treasury Board Secretariat has determined what its role should be, departments will have to develop systems capable of providing the kind of information on materiel management that the Secretariat needs to perform this role. These information systems must also be able to give departmental managers the data they need to assess performance and make informed judgements regarding materiel resources. The Auditor General stressed the need for such systems in his Report, observing that he had “found deficiencies in all the organizations’ materiel management information systems.” (23.36) Often, information could not be transferred from one system to another within departments and the data they contained was incomplete. As a result of these deficiencies, the actual costs of using and holding materiel were not fully known, and sound decisions regarding the procurement, use, and disposal of materiel could not be taken. Another consequence is that government departments may be holding inventories surplus to their needs; indeed the evidence reported by the Auditor General suggests that this is the case. Since departments cannot properly manage what they cannot count, we recommend:

That departments develop integrated information systems capable of providing their managers and Treasury Board Secretariat with data on materiel management practices and performance that is both timely and relevant. This information should include data on materiel inventories and holding costs.

The Committee also noted with some concern that Treasury Board policies that direct departments to make the costs associated with the use of materiel known to end users are not always adhered to. This is a situation that must be corrected promptly in order to encourage the prudent and economical use of resources. We therefore recommend:

That Treasury Board Secretariat and the departments take immediate steps to ensure that the costs associated with the use of materiel be made visible to end users.

The Committee understands that among the departments examined for the audit of materiel management, there are already major efforts underway to revise and simplify policies and to clearly define roles, responsibilities and accountability for materiel management. These steps are welcome and departments should make every effort to ensure they succeed. Establishing timetables and reporting on the status of these initiatives will help enable them to do so. The Committee therefore recommends:

That departments provide status reports and timetables on their initiatives under way to address long-standing materiel management deficiencies in Part III of their annual Estimates, beginning with fiscal year 1998-99.

The Committee considers that better materiel management is vital. We believe, therefore, that Treasury Board Secretariat should also report regularly to Parliament on the overall status of materiel management in the federal government. These reports should focus on the Secretariat’s role in this area, discuss improvements that have been made and concrete results produced. We therefore recommend:

That Treasury Board Secretariat report annually to Parliament on the status of materiel management in the federal government. In particular, such reports should include references to the status of accountability relationships, costs associated with holding materiel, details regarding initiatives to reduce these costs, and explicit statements of the amounts saved as a consequence.

Such reports should also draw Parliament's attention to those departments that have made real progress and those departments whose progress has fallen short of expectations.

Disposal of Surplus Materiel Assets

When materiel assets cease to be of use to departments, there are mechanisms in place to facilitate their disposal. Disposal of materiel is a means by which departments can reduce surplus inventories and also represents a source of potential income: the Auditor General reports that revenues from the disposal of surplus materiel are in excess of \$40 million a year. In addition, a study by Treasury Board Secretariat in 1995 reported that the potential annual cost savings from eliminating unnecessary inventory could reach \$1.25 billion. Although inventories may have been reduced since that time, the Auditor General indicates that the potential for significant savings still exists.

It therefore stands to reason that the disposal process should function smoothly and that departments should have all reasonable access to it. The Committee learned, however, that there is some confusion about the way this process should operate.

Under current policy, the Crown Assets Distribution Directorate (a unit of Public Works and Government Services Canada) is required to provide common services for the disposals of assets. In 1992, legislative changes were made to allow departments the option of using these services or taking care of disposals themselves. Following this change, some departmental disposal projects were set up on a pilot basis. Although some encouraging results were obtained, no decision has yet been made on the balance required between departmental initiative and the need for some central control and co-ordination of this activity. The Auditor General told the Committee that this issue is currently under study but that it should be resolved as soon as possible in order to take full advantage of the disposal option. Mr. Clayton assured the Committee that the results of the study should be released within days or months. The Committee looks forward to the conclusions and wishes to encourage their timely presentation. We therefore recommend:

That Treasury Board Secretariat and Public Works and Government Services Canada make the conclusions of their study of disposal mechanisms known by 30 September 1997 at the latest.

The Department of National Defence

Of the departments included in the audit, the Department of National Defence spent the most on materiel acquisition: \$4.2 billion during the 1994-95 fiscal year. The value of its materiel inventory was also quite considerable; the Department's own estimates indicated that these holdings had a value of approximately \$8.5 billion and a direct annual inventory management cost of \$567 million.

Because of the size of its materiel holdings and the scope of its efforts to introduce changes to the way it manages them, the Committee was anxious to hear from the Department on the progress it is making in this area; if such a large and complex organization can solve its problems in materiel management, this should serve as a source of information and encouragement to other departments and agencies.

The Committee learned that the Department has initiated a Cost-Visibility Project to supply its managers with better information on costs. Furthermore, unlike the other audited organizations, DND has a comprehensive, department-wide, asset and inventory management system. This system is not capable, however, of providing adequate aggregate information and is being upgraded. The Department has also identified materiel inventory surplus to its needs and is taking steps to reduce the excess. Ms Fréchette told the Committee that the Department has an overall objective to reduce its stocks of inventory by at least 30% over the next three years.

The Committee was encouraged that the Department is taking steps to correct problems in its management of materiel, and is anxious that these efforts remain on schedule and produce the expected results. We therefore recommend:

That the Department of National Defence establish a firm timetable for completion of its initiatives to renew its materiel management practices by 30 September 1997, and report its progress in Part III of its Estimates, beginning with fiscal year 1998-99.

The Committee is also concerned about the status of the Department's project to upgrade its supply system. According to the Auditor General, restructuring of materiel management in the Department depends to a great extent on successful completion of this project. He reports, however, that the project is at risk. (Exhibit 23.5) Ms. Fréchette, on the other hand, told the Committee that the Department has since modified its approach to the project and that the renewed system "will be delivered on time and within budget." (39:9) The Committee was gratified to receive these assurances.

III. CONCLUSION

The procurement and use of materiel is one of the federal government's costlier activities. It is therefore of vital importance that this activity be properly managed in order to keep costs to government and the taxpayers who fund it to a minimum. At the same time, these resources have to be intelligently managed in order to ensure that they deliver maximum value.

Based on its review of the Auditor General's audit of materiel management practices in four departments and agencies and the role of Treasury Board Secretariat in this area, and on meetings with witnesses, the Committee is encouraged by progress that has been made. To ensure that the initiatives that are under way produce the desired results the Committee believes that certain key steps must be taken. In particular, Treasury Board Secretariat must define its mandate clearly with regard to materiel management, accountability relations must be clarified, departments must develop systems that can record the right information on materiel use and holdings, and an appropriate disposal regime must be established quickly. The Committee firmly expects that its recommendations, combined with those made by the Auditor General, will help to ensure that public resources consumed by this aspect of what the federal government does will not be wasted.

Pursuant to Standing Order 109, the Committee requests the Government to table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue No. 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

REPORTS TO THE HOUSE

Thursday, 17 April 1997

The Standing Committee on Public Accounts has the honour to present its

EIGHTH REPORT

In accordance with its Order of Reference of Thursday, February 20, 1997, your Committee has considered Vote 30 under FINANCE in the Main Estimates for the fiscal year ending March 31, 1998 and reports the same.

A copy of the relevant *Minutes of Proceedings (Issue No. 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

REPORTS TO THE HOUSE

Wednesday, 23 April 1997

The Standing Committee on Public Accounts has the honour to present its

NINTH REPORT

Pursuant to Standing Order 108(3)(d), the Committee considered Chapter 17 of the September 1996 *Report of the Auditor General of Canada* (Human Resources Development Canada — Canada Pension Plan: Disability). The Committee held one meeting on this subject, on December 12, 1996, with representatives of the Office of the Auditor General and Human Resources Development Canada (HRDC).

As its name indicates, Canada Pension Plan: Disability (CPPD) is a component of the Canada Pension Plan (CPP), itself a component of Income Security Programs. CPPD benefits represent approximately \$3 billion, or 18% of total CPP payments. Since 1995, HRDC has been regionalizing its operations. CPPD operations now come under the responsibility of the Regional Branches, which report to the Deputy Minister (DM) on all departmental activities in their respective regions.

Eligibility for CPPD benefits is conditional: beneficiaries must (1) be between 18 and 65 years of age; (2) have contributed to the CPP for at least two of the last three years or five of the last 10 years before the date of the disability; (3) have been declared disabled according to the definition adopted by the CPP; and (4) apply in writing on the prescribed form. In 1996, disability benefits varied from \$326 to \$871 per month. Under certain conditions, beneficiaries may also be eligible for benefits for dependent children.

The number of CPPD beneficiaries rose from 155,000 in 1986-87 to nearly 300,000 in 1995-96, an increase of 93% and a compound annual rate of growth of 6.8%. In comparison, the labour force increased at a compound annual rate of growth of 1.1%. This phenomenon is not unique to Canada and has been observed in a number of other industrialized countries. Private-sector organizations working in the field of disability insurance have also seen a significant increase in the number of their clients.

Given this significant increase in costs, some observers may be led to believe that cost reduction necessarily means stricter eligibility criteria. The Committee wants to make it quite clear from the outset that it does not share that opinion. The Committee agrees with the Auditor General (AG) that it is possible to reduce CPPD costs considerably, through additional efforts to improve its management, without causing any prejudice to applicants who meet the eligibility criteria. At the meeting, the Committee noted that there were a number of areas where improvements to CPPD management could be made.

The Committee wants to emphasize that, at the meeting, HRDC DM Mel Cappe stated that HRDC agreed with most of the AG's recommendations. He added that HRDC was well aware that CPPD costs were rising and that the public was losing faith in CPPD's long-term viability. He noted that HRDC had taken measures in order to solve this problem. However, he added:

Even with our initiatives to date, our department recognizes and accepts the challenge to improve certain aspects of the management of the program. In fact, we have appointed a senior departmental manager to head a special project [. . .]. It will coordinate and monitor the implementation of the

measures already in progress, as well as new initiatives to address the Auditor General's recommendations (37:4).

HRDC also submitted to the Committee an action plan with eight priorities. The action plan notes present and future measures by HRDC in response to the AG's observations. Over half these measures are to be implemented by March 1997, and nearly all by March 1998. The DM made a commitment to provide the Committee with interim reports on its action plan in April 1997 and April 1998.

The Committee is of the opinion that the action plan clearly shows HRDC's will to manage CPPD better, and encourages HRDC to pursue its efforts to this end. However, the Committee believes that implementing the action plan cannot solve all HRDC's management problems. As the AG summarized the situation at the meeting:

An action plan cannot change the culture of an organization on its own. To successfully implement the changes that are required, management of the department and of CPP must show leadership by setting out the general policy direction they intend to follow with disability. This would require such measures as, first, demonstrating determination and continuity with respect to corrective measures that need to be implemented even in a context of rapid change; second, deciding whether proactive management is required with respect to this very large caseload; third, redoubling efforts to obtain closer cooperation among interested stakeholders; and finally, encouraging staff to be attentive to the better management practices of other plans (37:2).

It is clear to the Committee that better CPPD management does not mean a witch hunt for abusers of the system. It is of the utmost importance that program managers remain understanding at all stages of the process. Nevertheless, the persons receiving benefits under the program will be the main ones to benefit from improvements to it: faster application processing and less paperwork will ensure easier access.

In this respect the Committee recommends the following:

That, in developing an official quality control program, HRDC develop performance indicators to determine whether HRDC is achieving the program's objectives. HRDC is to inform the Committee of these indicators in the April 1998 interim report on its action plan;

That HRDC increase the exchange of information with workers' compensation boards, provincial social service departments, and private insurance companies with the view of increasing the efficiency of the program; and

That HRDC evaluate the possibility of making greater rehabilitation efforts in order to allow more beneficiaries to benefit from the rehabilitation program.

Pursuant to Standing Order 109, the Committee requests the government to present a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Issue 3 which includes this Report)* is tabled.

Respectfully submitted,

Michel Guimond

Chair

APPENDIX D

REPORT ON THE AUDIT OF THE PRESIDENT OF THE TREASURY BOARD'S REPORT TO PARLIAMENT:

TABLINGS IN PARLIAMENT FOR PARENT CROWN CORPORATIONS: ANNUAL REPORTS AND SUMMARIES OF CORPORATE PLANS AND BUDGETS

The *Financial Administration Act* requires the President of the Treasury Board to lay before each House of Parliament a report concerning the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act.

The report on these tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the *Financial Administration Act*. Accordingly, the report is required to indicate the time at, before, or within which the annual reports and the summaries of corporate plans, capital budgets and operating budgets (and amendments to them) were required to be tabled before each House during the reporting period; and the time they were actually tabled. The report on tablings is the responsibility of the President of the Treasury Board and is included in his annual report to Parliament, *Crown Corporations and Other Corporate Interests of Canada*, which is required to be tabled not later than 31 December 1997. (Not tabled at time of going to press.)

As required by subsection 152(2) of the *Financial Administration Act*, I have audited the information contained in the President of the Treasury Board's report on tablings for the year ended 31 July 1997. Further, I am required to report on this audit in my annual Report to the House of Commons.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the report on tablings is free of significant misstatement. My audit included examining, on a test basis, the systems and procedures used by the Treasury Board Secretariat to monitor the tabling of the summaries and annual reports in each House of Parliament, and the information contained in the report. Accordingly, it included such tests and other procedures as I considered necessary in the circumstances.

In my opinion, the information contained in the report on tablings is accurate in all significant respects in accordance with the description of the Deadlines for Tablings in Parliament disclosed in the report.

The following paragraphs are intended to highlight certain information that I believe may be of interest to members of the House of Commons.

This year's report on tablings identifies 38 instances of documents that were tabled late, relating to 15 of 37 Crown corporations required under the *Financial Administration Act* to table reports in the year. The report does not, however, identify that the 1995 Capital Budget Summary Amendment for Laurentian Pilotage Authority has not yet been tabled in either House of Parliament (deadlines were 22 April 1996 for the House of Commons and 12 June 1996 for the Senate).

Further, although not technically required to be disclosed in the report on tablings, the corporate plans of Atomic Energy of Canada Limited for 1995-96 to 1999-2000 and 1996-97 to 2000-01 have not, as required by subsection 122(1) of the *Financial Administration Act*, been approved by the Governor in Council. As a result, corporate plan summaries for these periods have not been tabled in either House of Parliament.

John Wiersema, CA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada

3 October 1997

APPENDIX E

The Costs of Crown Corporation Audits Conducted by the Office of the Auditor General of Canada

Section 147 of the *Financial Administration Act* requires that the Office disclose the costs of preparing audit reports on all Crown corporations other than those exempted under section 85 of the Act (see Exhibit 1). An audit report includes an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also include reporting on any other matter deemed significant.

The Office is also required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 1997, the full cost of the annual audit report was \$439,982.

Section 138 of the *Financial Administration Act* requires that, at least once every five years, each parent Crown corporation named in Schedule III of the Act undergo a special examination. This is distinct from the requirement for the annual audit of financial statements.

The objective of a special examination is to determine whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that:

- assets have been safeguarded and controlled;
- financial, human and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

In 1996-97 the Office completed the special examination of Petro-Canada Limited and the cost was \$21,190.

Exhibit 1**Costs of Preparing Annual Audit Reports for Fiscal Years Ending on or before 31 March 1997**

Crown Corporation	Fiscal Year Ended	Cost Incurred
Atlantic Pilotage Authority	31.12.96	\$ 60,008
Atomic Energy of Canada Limited (Joint Auditor)	31.03.97	248,549
Business Development Bank of Canada (Joint Auditor)	31.03.97	211,400
Canada Deposit Insurance Corporation	31.03.97	184,321
Canada Development Investment Corporation (Joint Auditor)	31.12.96	33,949
Canada Lands Company Limited (Joint Auditor)	31.03.97	98,958
Canada Lands Company (Vieux-Port de Québec) Inc.	31.03.97	6,130
Canada Mortgage and Housing Corporation (Joint Auditor)	31.12.96	288,725
Canada Museums Construction Corporation Inc.	31.03.97	9,432
Canadian Commercial Corporation	31.03.97	103,645
Canadian Dairy Commission	31.07.96	125,987
Canadian Museum of Civilization	31.03.97	76,218
Canadian Museum of Nature	31.03.97	91,392
Cape Breton Development Corporation	31.03.97	299,692
Defence Construction (1951) Limited	31.03.97	31,749
Enterprise Cape Breton Corporation	31.03.97	79,581
Export Development Corporation	31.12.96	333,653
Farm Credit Corporation	31.03.97	318,696
Freshwater Fish Marketing Corporation	30.04.96	85,657
Great Lakes Pilotage Authority, Ltd.	31.12.96	61,369
Laurentian Pilotage Authority	31.12.96	86,363
Marine Atlantic Inc. (Joint Auditor)	31.12.96	181,962
National Capital Commission	31.03.97	193,838
National Gallery of Canada	31.03.97	64,036
National Museum of Science and Technology	31.03.97	57,185
Old Port of Montreal Corporation Inc.	31.03.97	75,115
Pacific Pilotage Authority	31.12.96	47,689
Petro-Canada Limited	31.12.96	18,181
Queens Quay West Land Corporation	31.03.97	26,411
Royal Canadian Mint	31.12.96	310,206
The St. Lawrence Seaway Authority	31.03.97	112,519
Seaway International Bridge Corporation Ltd.	31.12.96	49,800
The Jacques Cartier and Champlain Bridges Incorporated	31.03.97	71,928
Standards Council of Canada	31.03.97	38,458
VIA Rail Canada Inc. (Joint Auditor)	31.12.96	214,040