

April 1998

Foreword and Main Points

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Report of the Auditor General to the House of Commons for April 1998

Foreword

I am pleased to present the April volume of my 1998 Report. Bound with this Foreword are the Main Points of nine chapters, which are issued separately:

1. Expenditure and Work Force Reductions in the Public Service
2. Expenditure and Work Force Reductions in Selected Departments
3. National Defence — Equipping and Modernizing the Canadian Forces
4. National Defence — Buying Major Capital Equipment
5. Revenue Canada, Department of Finance and Department of Justice — Interdepartmental Administration of the Income Tax System
6. Population Aging and Information for Parliament: Understanding the Choices
7. Federal Laboratories for Human and Animal Health Building Project
8. Department of Finance — Effectiveness Measurement and Reporting
9. Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards

Government-wide expenditure reductions over the last few years have left many departments with fewer resources and less flexibility to meet new and changing priorities. This Report notes that departments are having to make more difficult choices among programs and projects they fund, practices and processes they follow, and services they provide or the ways they provide them.

In this environment, it is more important than ever that spending choices be made on the basis of solid information. Decision makers need to research the costs, benefits and risks associated with various options before they commit scarce funds to major purchases. Clear performance standards must be set, and ongoing monitoring is needed to ensure that those standards are met along the way. Various chapters in the Report discuss these aspects of several major government projects.

Other countries have preceded Canada in the streamlining of government, and their experience provides useful lessons that could be adapted to Canadian efforts. These are also noted in some of the chapters.

And finally, certain chapters comment on the need for the government to provide solid and objective financial information that Canadians, and Canada's partners, can count on when they make decisions whose impacts will continue for decades to come.

Expenditure and Work Force Reductions in the Public Service

Chapter 1 - Main Points

1.1 Expenditure and work force reductions have affected the public service and public servants for more than a decade. In 1995, the government launched Program Review, an initiative aimed at rethinking and realigning government programs in light of fiscal restraints.

1.2 To better manage expenditure and work force reductions, central agencies moved from imposing, directing and prescribing to providing leadership, guidance and support to departments. For example, instead of adopting the “one size fits all” approach, Treasury Board Secretariat proposed a management and accountability framework to departments and allowed incentive programs to take into account the differences in their context and operational environment.

1.3 Program Review was a success from many perspectives. The deficit has been reduced and personnel costs have decreased for the first time in more than a decade. In spite of a difficult climate, reductions were implemented without major work disruptions; and financial departure incentives have been effective in minimizing layoffs.

1.4 The cost of achieving work force reductions was high, however, not only in dollar terms but in human terms as well. For example, between 1992 and 1997 the government paid incentives to some 46,000 public servants, military and RCMP members to leave or retire. Furthermore, work force reductions have amplified a number of human resource issues, such as the need for rejuvenation and renewal and the need to modernize and simplify human resource systems. Many studies and our own audit work indicate that the public service is an institution under significant stress and that strong actions are now required.

1.5 Significant improvements were made in the management framework put in place by central agencies. Nonetheless, more efforts are needed to improve the management of work force reductions — for example, in critical occupational groups where there might be surpluses in some departments but shortages in others.

1.6 There is a need to improve accountability to Parliament for expenditure and work force reductions, and for the related costs. Roles, responsibilities and accountabilities of central agencies and departments in the management of work force reductions also need to be clarified.

Expenditure and Work Force Reductions in Selected Departments

Chapter 2 - Main Points

2.1 As a result of a lengthy period of fiscal restraint and recent expenditure reduction programs, some federal government agencies have been abolished, some departments merged and others reduced in size. It is estimated that the public sector work force will have been reduced by approximately 45,000 employees between April 1995 and March 1998.

2.2 We selected seven departments to examine how and the extent to which expenditure reductions have been implemented. These organizations, representing over 170,000 employees, differed in size, structure and reduction targets.

2.3 Generally, departments we reviewed met their 1995-96 and 1996-97 expenditure and work force reduction requirements. Given progress to date, we expect that most of them will meet their reduction targets for the remaining two years of Program Review.

2.4 We found that ministerial commitment and departmental leadership were evident in setting direction and attaining momentum. Factors such as the size of the reduction, readiness for change and the time available to plan had an effect on departments' strategic planning for reduction. Departmental implementation of reduction was generally rigorous and employees were well informed both prior to and during the reduction process.

2.5 Although most reduction targets were met, and overall compliance with work force reduction policies had improved since our 1992 Report chapter, Payments to Employees under the Work Force Adjustment Policy, we found questionable actions in some departments. The need for incentive packages was not always well researched and there was a tendency to call for volunteers prior to identifying positions surplus to requirement. Best practices suggest that an organization should conduct a thorough cost/benefit analysis of alternatives; target incentives to areas where they are needed most; and identify the extent to which there is a need to call for volunteers.

2.6 Departments focussed primarily on meeting reduction targets in a timely manner. Less emphasis was placed on cost management. Such factors as the initial lack of necessary financial and human resource information, departments not having to fund entirely the departure incentives they provided, and an unclear Treasury Board Secretariat accountability structure for departmental work force reduction costs contributed to a general lack of cost consciousness in departments.

2.7 Throughout work force reduction, departments treated departing employees in a humane and sensitive manner. Departments paid less attention generally to those who remained and to their concerns regarding the loss of experienced and qualified colleagues, the level of workload per employee and future departmental direction. Departments have now entered a period of transition that will require not only adjusting organizational structures and operations but also paying particular attention to ensuring that work force capability meets future operational demands.

National Defence —

Equipping and Modernizing the Canadian Forces

Chapter 3 - Main Points

3.1 A modern, multi-purpose, combat-capable force able to “fight alongside the best, against the best” is necessary to fulfil Canada’s defence policy commitments, although the policy does not require the Canadian Forces to possess every component of military capability.

3.2 According to Department of National Defence officials, Canada’s White Paper commitments are defined by the defence capabilities of the Canadian Forces. We found many equipment deficiencies that limit capabilities.

3.3 If the status quo persists, the Department’s available capital funding may not be sufficient to equip and modernize the force that National Defence is currently planning. Officials told us that they expect to be able to increase the capital portion of the budget. Nevertheless, they anticipate that hard choices may have to be made.

3.4 Personnel, operations and maintenance costs are rising, which is further reducing the portion of the budget available for capital equipment.

3.5 We found that the Department does not have an adequate policy framework to direct the almost \$1.4 billion it spends each year on equipment modernization. It does not yet have in place fully developed operational scenarios to guide planners, or performance information that identifies gaps.

3.6 Some other countries — notably the United States and New Zealand — have taken the lead in the way their government budgeting and management systems actively manage defence policy and resources.

National Defence —

Buying Major Capital Equipment

Chapter 4 - Main Points

4.1 National Defence plans to spend almost \$6.5 billion over the next five years to purchase equipment that Canada's armed forces need to carry out their assigned tasks. As Chapter 3 indicates, the Department's available capital funding may not be sufficient to equip and modernize the force that is currently planned.

4.2 This chapter reports our findings on the management of six major capital projects with a total value of \$3.3 billion.

4.3 All six projects we examined are likely to meet their contract cost and performance objectives. For example, the Eryx anti-tank missile system and the Coyote reconnaissance vehicle appear to perform especially well and have attracted the interest of foreign armed services. Nevertheless, we are concerned about several of the management practices we observed.

4.4 We found that defence policy allows wide latitude in the level of equipment capability required. We noted in the projects we examined that affordability constraints resulted in only low-end capability being purchased, limitations in the number purchased, or both:

- the Maritime Coastal Defence Vessel is acquiring two sets of mechanical minesweeping gear for 12 ships effective only against some types of mines, and has not acquired some of the equipment necessary to patrol effectively in darkness and poor visibility;
- the Leopard C1 tank is being fitted with only an improved sight, although the army had considered a complete upgrade, including the gun and armour, to be the "minimum viable" option;
- the Griffon helicopter cannot meet the army's original lift and communications requirements;
- fewer Eryx missiles and Coyote vehicles have been purchased than were originally intended.

4.5 We are concerned at the extent to which the Department relies on professional judgment in making complex purchase decisions. Management did not conduct adequate analyses to justify its spending decisions for most of the projects we examined. Tactical studies often did not reflect the way officials said they actually planned to employ equipment, were done too late to influence decisions, produced results that contradicted the purchase decision, were undertaken by contractors who had an interest in the Department's decision, or were not done at all.

4.6 In three cases, the Department considered only a single option. In other cases, the options analyses were inadequate.

4.7 Only one project of the six fully met our expectations for a rigorous risk management process. No project we examined has suffered major problems so far because of this, but we identified several instances where better risk management might have improved project delivery.

4.8 Although test and evaluation processes were satisfactory in most cases, for some of the projects that involved commercially based designs, the equipment was not tested under actual operating conditions until after it had been introduced into service. Problems have since been discovered that have affected the operational capability of some of the equipment. The Department is currently working to resolve these problems.

4.9 The Department began a major management renewal program in 1994 that included the capital acquisition process. Because it considered other areas to be more important, it deferred work on capital equipment acquisition and it does not yet have an implementation plan. The Department has begun work on the plan, including three pilot projects. Because equipment acquisition is a government-wide process, the Department is working with Public Works and Government Services Canada, Industry Canada, and the private sector to improve government practices. We believe the departments concerned must develop a plan with definite dates and milestones to complete their reform process.

Revenue Canada, Department of Finance and Department of Justice

Interdepartmental Administration of the Income Tax System

Chapter 5 - Main Points

5.1 Three departments play a key role in administering the income tax system. The Department of Finance is responsible for the formulation of tax policy and the introduction of new tax legislation, Revenue Canada oversees the administration of tax laws and the Department of Justice provides legal advisory services and litigation services to both Finance and Revenue Canada.

5.2 Efficient and effective relationships among Revenue Canada, the Department of Justice and the Department of Finance are essential for the smooth functioning of the income tax system. This audit was undertaken because our past work had raised some concerns about the management of risk to the tax base. Our current examination found that the departments have taken many important measures to improve their relationships. We have been told that the proposed change of Revenue Canada to a new Canada Customs and Revenue Agency will not affect their relationships.

5.3 An important aspect of managing the risk to the tax base is the identification and correction of legislative deficiencies. We found that Revenue Canada and the Department of Justice regularly bring deficiencies to the attention of the Department of Finance. However, the correction of legislative deficiencies is left to the discretion of the Department of Finance.

5.4 As all three departments are key players in managing the risks arising from legislative deficiencies, it is important that they all be involved in deciding which deficiency should be given priority.

5.5 The management of tax litigation risks has been improved. However, Revenue Canada and the Department of Justice need to strengthen the partnership arrangement for planning litigation needs and managing the risks.

5.6 Settlements of income tax disputes resolved through consent judgments have been made on a mix of law and facts. Revenue Canada should provide transparency in the settlement agreements it undertakes. As an example, United States income tax law provides public access to settlement agreements, with privacy protection of the taxpayer's identity.

Population Aging and Information for Parliament: Understanding the Choices

Chapter 6 - Main Points

6.1 Canada today is sitting on a very favourable demographic structure, with a historically low ratio of youth and elderly to the working-age population. In the coming few decades, this situation will be radically transformed. By the second decade of the next century, when the leading edge of the baby boom generation reaches normal retirement age, the growth in Canada's elderly population will accelerate while that of the working-age population will slow to a crawl.

6.2 This demographic shift has the potential to affect government finances in a significant way. An aging population puts pressure on government spending through higher pension payments and increased demands for health care services. Also, unless there are significant changes in the patterns of work, this demographic change will reduce labour force growth dramatically, which in turn would slow down economic growth and, with that, the growth in government revenues. This combination could put enormous pressures on our public finances when the full impact of this demographic change is felt by the second decade of the next century, particularly if Canada's debt burden and tax levels remain high.

6.3 The government is well aware of these pressures; during consultations on reforming specific programs like the Canada Pension Plan, it provided detailed projections of the effects of demographic forces on CPP finances. This longer-term information not only helped inform public debate, but also motivated acceptance of the need for change. To a lesser extent, as government began discussing reforms to Old Age Security and the Guaranteed Income Supplement (the Seniors Benefit), it again provided longer-term projections of the financial impacts.

6.4 Yet what it has done to highlight the impact of demographics on the financial health of individual programs, it has failed to do for the financial health of the government as a whole. Consequently, parliamentarians are left to make annual financial decisions, many of which have lasting consequences, without a macro perspective — a summing up of the financial impacts that demographics can potentially have on the government's long-term financial health.

6.5 The importance of appropriate information to help parliamentarians understand the government's financial condition is clearly a responsibility and a theme on which we have reported over the last six years. This chapter, illustrating the feasibility of preparing such longer-term information and the significance of that information, is a continuum of the "Information for Parliament" chapters in our 1993 and 1995 Reports. The particular contribution of this chapter is its focus on the role of demographics in assessing the government's financial condition.

Federal Laboratories for Human and Animal Health Building Project

Chapter 7 - Main Points

7.1 The new Federal Laboratories for Human and Animal Health in Winnipeg contain some of the most advanced diagnostic, research and training facilities of their kind in the world. The facility is the first in the world to combine laboratories concerned with both human and animal diseases, and the first in Canada capable of handling the most dangerous viruses known. The facility is to be used by Health Canada and the Canadian Food Inspection Agency.

7.2 International experts involved in reviewing the design and construction of the facility have noted that it is extremely secure with regard to containment of biohazardous materials.

7.3 Despite a lengthy history of project proposals by Agriculture and Agri-Food Canada and Health Canada to construct new laboratory facilities, the Winnipeg project was undertaken without adequate analyses of existing laboratory capacity. The Winnipeg facility currently has space that exceeds its planned program needs and the amount approved by Treasury Board, and that has added to a national inventory of surplus laboratory capacity.

7.4 Health Canada and the Canadian Food Inspection Agency have informed us that they recognize the importance of ensuring that the facility is fully used, including the need to explore potential cost-recovery opportunities. To date, however, a comprehensive business plan and strategy for achieving these aims has not been developed.

7.5 In our opinion, the project is approximately 12 months behind schedule and could have been delivered for at least \$5 million to \$10 million less. In addition, the approved project budget of \$141.8 million does not accurately reflect the project's total cost to the taxpayer, currently estimated at \$176 million. The proposed project budget did not identify all project costs, as required by Treasury Board policy.

7.6 We identified several areas where Public Works and Government Services Canada can improve its practices in selecting and managing consultants on future complex projects like this one. We also noted that shared authority and accountability require careful management to mitigate risks of project delays and added costs.

7.7 As we have noted in reviewing other government projects, the current "build [up] to budget" approach, the lack of systemic incentives for seeking cost savings within approved budgets, and the absence of a departmental culture that supports such aims do not encourage the parties to identify and realize potential cost savings.

7.8 The new facility is a potential source of pride for all Canadians as it contributes to the global effort to identify and combat human and animal infectious diseases. Due to the nature of its programs, the Winnipeg laboratories will be expensive to operate and maintain. The challenge for Health Canada and the Canadian Food Inspection Agency will be to ensure that the full potential of this new facility is achieved.

Department of Finance —

Effectiveness Measurement and Reporting

Chapter 8 - Main Points

8.1 In addition to functions that include preparing the Budget and providing economic policy advice to the government, the Department of Finance has responsibilities related to a number of policies and programs. The Department's 1997-98 planned expenditures of \$66 billion account for 43 percent of planned federal expenditures. The Department is also responsible for federal tax policy, including preferential tax provisions that are intended to lead to the achievement of a variety of government policy objectives.

8.2 The significance of the Department's policy and program responsibilities underlines the importance of its obligation to make known to Parliament and to the public, in a clear and meaningful manner, the nature and extent of those responsibilities, the objectives involved and the results achieved relative to those objectives.

8.3 Improvement is required in providing Parliament with clear and consistent statements of objectives and of the Department's policy and program-related responsibilities. For many policies and programs, the Department shares responsibilities with other departments and agencies. We found a general lack of clarity in documents directed to Parliament about the other departments and agencies involved and the manner in which responsibilities are shared.

8.4 We found gaps in reporting to Parliament on results achieved relative to objectives. Our findings in this audit are consistent with the findings of a number of audits of individual policies and programs undertaken by this Office over the past six years. The picture that emerges is one of known shortcomings, and insufficient attention to measuring effectiveness and reporting results to Parliament and the public.

8.5 Legislative provisions governing a number of the Department's policies and programs have been the subject of review by Parliament to consider whether the provisions should be changed to improve performance and to enable policies and programs to be adapted to new circumstances. Such legislative reviews are valuable in their own right; they are not, however, a substitute for systematic measurement and reporting of effectiveness information by the Department. We believe legislative reviews would be enhanced by Parliament having more regular and timely access to information on the results that policies and programs have achieved.

8.6 Planning for effectiveness measurement and reporting is not sufficiently linked with the Department's corporate planning process. The Department's current approach results in an effectiveness measurement function that is partial in coverage and not clearly integrated with the overall corporate management structure. In view of the limited resources allocated specifically to the function, we are concerned about the Department's capacity to meet its obligations to account to Parliament for results achieved.

Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards

Chapter 9 - Main Points

9.1 The 1980s and early nineties have seen major advances in financial reporting by sovereign governments, with Canada among the leaders. However, over the past two years the Government of Canada has begun departing from both objective accounting standards and its own stated accounting policies for certain transactions. Moreover, the 24 February 1998 Budget indicates that a similar departure will occur in 1998.

9.2 In 1996, transitional assistance for harmonizing PST with GST was included in the deficit even though provinces had not yet agreed to the harmonization by the end of the year. In 1997, funding of the Canada Foundation for Innovation was included in the deficit even though the Foundation did not exist by the end of the year. In 1998, the 24 February 1998 Budget indicates that funding of the Canada Millennium Scholarship Foundation will be included in financial results whether or not the Foundation exists by the end of the year.

9.3 As auditors of the government's financial statements, we are deeply concerned over this recent disregard by the government for objective accounting standards in reporting its financial results to Parliament and to Canadians. This is not merely a technical disagreement between an accountant and an auditor. Objective accounting standards are accepted and identifiable standards that are established by an arm's-length standard-setting body - the Canadian Institute of Chartered Accountants (CICA). Business firms cannot depart from objective accounting standards established by the CICA, to hide losses or to hide profits. Parliamentarians should expect no less from the government.

9.4 Meeting the significant challenges of the next decade will require, among other things, credible annual reports by the government on its overall financial health. In our view, departures from CICA standards and the government's own accounting policies must cease if credibility is to be restored to the reports that parliamentarians and others need.

9.5 Accordingly, we have recommended that the Government of Canada ensure that its accounting policies and practices conform with recommendations issued by the CICA's Public Sector Accounting and Auditing Board. Implementation of this recommendation will require continued diligence by the Public Accounts Committee of the House of Commons in reviewing the government's annual financial statements.

9.6 Although this chapter calls Parliament's attention to inappropriate accounting, there are related concerns that we have and will continue to report separately. They deal with accountability and parliamentary oversight for entities such as the Innovation Foundation and the Millennium Scholarship Foundation, and with whether or not such entities are, in substance, operating at arm's length from the government.

Report of the Auditor General of Canada to the House of Commons - 1998

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Matters of Special Importance - 1998

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Matters of Special Importance - 1998

Main Points

Each year in this chapter I highlight significant issues arising from our work of the year, and matters from previous years that continue to be of special importance. This year, with the era of large, chronic deficits seemingly behind us, I discuss the challenge of remaining focussed on improving economy and efficiency in government.

I suggest a number of means to help ensure that the turnaround in our immediate fiscal situation does not lull us into complacency or deflect attention from the need to improve performance:

- **A long-term fiscal framework.** For some time now, I have called on the federal government to make public long-term fiscal projections showing the effects on government finances of factors such as population aging. Governments in other countries are doing this.
- **Effective governance structures.** The federal government, like governments elsewhere, is trying to move from a traditional bureaucratic model to a more flexible form of management. This requires good governance, with attention to serving the public interest, achieving objectives, ensuring accountability and maintaining transparency.
- **Innovation and sensible risk taking in the public sector.** There are constraints to innovation and sensible risk-taking in the public sector. We need to identify these constraints more clearly, along with the actions that can be taken to encourage public servants to discharge their responsibilities with creativity, innovation and integrity.
- **Modernized financial management and reporting.** Modernization of financial management is long overdue. As well, the government's commitment to objective accounting standards needs to be reaffirmed — for two years now, I have felt obliged to qualify my audit opinion on the government's financial statements because they fail to meet accepted accounting standards.
- **Better integration of people management with ongoing public sector reforms.** There is much dissatisfaction among government officials with the current state of human resource management in the public service. It is troubling that these long-standing problems still exist.
- **Open and meaningful accountability to Parliament.** Significant steps are being taken to provide parliamentarians with the kind of timely, relevant information they need to hold government accountable. The move to alternative service delivery arrangements requires attention to prevent a weakening of accountability and cohesion in the public sector.

In this post-deficit environment, these elements of good public sector management can help to ensure that the pursuit of better value for the taxpayer's money continues.

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

- Our first assessment of performance information by a new service delivery agency was completed this year.
- Our examination of Revenue Canada's efforts to promote integrity among its employees continues our ongoing work on ethical conduct in the public sector.
- We examined the government's requirement that specified foreign property be reported for tax purposes.
- Progress in implementing the government's science and technology strategy has been slow in some important areas.
- Delays in fixing Year 2000 computer problems mean that many government-wide critical functions remain at risk.
- Moving beyond the rhetoric of sustainable development to apply its principles in the day-to-day operations of government remains a key challenge.
- Over the past year, our audits have identified opportunities for cost savings.

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.*

Public Management in a Post-Deficit Environment

The prospect of being hanged, Samuel Johnson observed, concentrates the mind wonderfully. In the early 1990s, Canada's public finances — already weak from years of continuous deficits and mounting debts — were brought to the brink of crisis by an unusually long and deep recession. In 1993-94, the annual budget deficit reached a record \$42 billion and the net debt as a share of GDP rose to over 70 percent, compared with less than 20 percent two decades earlier. The spectre of financial crisis encouraged the government to rethink radically what it does and how it does it.

Significant changes in federal public administration followed. A new Expenditure Management System was introduced, establishing multi-year funding targets and requiring that new spending initiatives be financed through reallocation within those targets. Programs were privatized; others were restructured and streamlined. The size of the public service work force was reduced in a meaningful way for the first time in decades, as was program spending. Emphasis was placed on management becoming more results-oriented and cost-conscious.

With the era of large chronic deficits seemingly behind us, the challenge now is to maintain the momentum toward greater economy and efficiency in managing public funds. Eliminating the deficit is only a way station to restored fiscal health — not the end of the road. Our debt and tax burdens remain high, and current demographic trends suggest additional fiscal pressures ahead. The global economic upheavals of recent months provide a vivid reminder of how quickly economic fortunes can change. It is thus important that we not allow the turnaround in our immediate fiscal situation to lull us into complacency or to deflect our efforts to improve performance.

In this chapter, I discuss some means that could support those efforts. They include:

- a long-term fiscal framework;
- effective governance structures;
- innovation and sensible risk-taking in the public sector;
- modernized financial management and reporting;
- better integration of people management with ongoing public sector reforms; and
- open and meaningful accountability to Parliament.

Together, these elements would constitute a public management culture that in my view would stand us in good stead generally, and particularly in the current post-deficit environment.

Other issues that are not directly related to the theme of managing in a post-deficit environment but that I consider important are reported in a supplement to this chapter.

A Long–Term Fiscal Framework

Jacob’s son Joseph saved Egypt from famine — and made himself rich and famous in the process — by counselling Pharaoh to look beyond the immediate years of plenty, and to budget accordingly. In making budget decisions, a forward view is nothing more than simple prudence. It is especially wise when we have reason to expect, as Joseph did, that our circumstances in the long term may be materially different from our present.

We lack Joseph’s ability to foretell the future through the interpretation of dreams, but it is easily within our power to extrapolate the long–term fiscal implications of existing demographic trends. Demographic developments take decades to unfold, and follow a predictable pattern as they do: today’s youth will be tomorrow’s workers in a decade or two and Canada’s retirees three to four decades after that. In a real sense therefore, as management expert Peter Drucker has put it, demographics represent “a future that has already happened.”

What does that future look like? We know that owing to lower fertility and mortality rates, Canada’s population is aging. The proportion of elderly in the total population will grow sharply during the second and third decades of the next century, as baby boomers age and leave the labour force for retirement. By 2030, Canada’s elderly will represent 22 percent of the total population, compared with 12 percent today. Whereas today there are five Canadians of working age for every person 65 years or older, in three decades there will be only half that number.

Given current policies, this demographic shift will impose huge fiscal pressures on government, as demands on our pension and health care programs increase while the proportion of the working age population supporting these programs shrinks. A fiscal outlook limited to a two–year horizon is clearly far too short to take these pressures into account. That focus was effective in a period of crisis, but now it is time to look beyond the short run.

Among developed countries at least, there is a growing recognition of the advantages of long–term fiscal planning. Recent reports of the Organization for Economic Co–operation and Development (OECD) have stressed the value of long–term budget frameworks in forcing people to think about the future. New Zealand, Australia and the United Kingdom, countries with parliamentary systems of government similar to our own, have adopted legislation that obliges their governments to provide long–term fiscal outlooks as part of their budget processes. In the U.S., both the Congressional Budget Office, on behalf of Congress, and the Office of Management and Budget, on behalf of the Administration, prepare and make public comprehensive projections of revenues, expenditures and budget balances under various fiscal and economic assumptions for several decades ahead.

Budgeting in New Zealand

Budget making and reporting in New Zealand are governed by the *Fiscal Responsibility Act 1994*. The Act requires that fiscal policy be made in accordance with the following principles of responsible fiscal management:

- Reducing government debt to prudent levels
- Matching operating expenses with revenues over time
- Pursuing policies consistent with stable and predictable tax rates over time

These principles find concrete expression in two publications: a budget policy statement, to be tabled at least three months before budget time, and a fiscal strategy report to be tabled with the budget.

The policy statement sets out the government's fiscal intentions for the ensuing three years and its long-term fiscal objectives.

The strategy report compares the budget objectives with those in the policy statement and provides "progress outlooks" that *project the government's fiscal position for 10 years or more, under a range of economic and policy assumptions*.

The *Fiscal Responsibility Act* has been the model for similar legislation in Australia and the UK.

I have at various times called for similar projections for Canada. The government's reluctance to accede to these calls stems largely from an expressed concern that it will be held accountable for the projected long-term outlooks, in the same way it is now accountable for its short-term fiscal targets. One way around that fear is to make it clear, either through a policy statement accompanying the projections or through legislative enactment if necessary, that the projections are provided for information purposes only and do not represent government commitments — which would be meaningless, anyway, given the normal length of a typical government's mandate. In addition, long-term projections need not contain the same precision and type of information now contained in the government's two-year forecasts.

Presentation of these long-term projections as part of the fiscal update in the fall, rather than with the annual Budget in February, would also help distance them from the government's short-term fiscal plan and targets. At the same time, it would provide useful context for the pre-Budget consultations that are the reason for producing the fall fiscal update.

I was pleased recently to see the Standing Committee on Public Accounts endorse the need for a long-term outlook in budget making. In its 16th report tabled last October, based on hearings on Chapter 6 of my 1998 Report, the Committee calls on the Department of Finance to devise appropriate means for the government to publish long-term demographic and fiscal information that would ensure transparency and greater understanding of Canada's fiscal prospects. I hope the Department will respond favourably to the Committee's call.

Long-term fiscal projections are necessarily speculative, but necessary nevertheless: one cannot ignore the future just because it is not perfectly predictable. Current fiscal decisions have long-term consequences, whether we recognize them or not. Demographic trends are as reliable as any, and their fiscal implications can easily be taken into account. Doing so and making the results of the exercise

public would help to make the government's short-term targets more intelligible — and hence more acceptable to the public and more credible to financial markets.

For related information, see Auditor General publications: Population Aging and Information for Parliament: Understanding the Choices (1998 Report, Chapter 6); Information for Parliament — Deficits and Debt: Understanding the Choices (1995 Report, Chapter 9); Toward Better Governance — Public Service Reform in New Zealand 1984-94 and its Relevance to Canada (1995); Information for Parliament — Understanding Deficits and Debt (1993 Report, Chapter 5). Other publications: Maintaining Prosperity in an Ageing Society (OECD, 1998); Long-Term Budgetary Pressures and Policy Options (Congressional Budget Office, Washington, DC, May 1998).

Effective Governance Structures

Ideas about what works in the public sector, and what effective public management is, have undergone a sea change over the past decade or so. Traditional public management is characterized by hierarchical organizational structures, centralized decision-making, and regulation of operating departments through controls imposed by central agencies. It is based on detailed rules, rather than managerial judgment; on process, not results.

These bureaucratic features of traditional public management were designed to ensure equity across government activities and probity in the stewardship of public resources. But they can also make the public sector unwieldy, inflexible and inefficient. In a world of rapid change, mounting competition and a more demanding public, this traditional bureaucratic model of public management is becoming less and less acceptable.

In country after country within the industrialized world, this old-style approach to public sector management is giving way to a more decentralized, flexible management, geared to results and performance. Policy direction and overall budget allocations still emanate from the centre, but operating departments have greater autonomy in the way they use resources to meet client needs. Accountability is achieved through the establishment of appropriate performance objectives and reporting requirements.

Through a number of initiatives under the general rubric of “getting government right”, the federal government has embarked on a road toward results-based management in the public sector. Critical to the success of this approach are control frameworks and governance procedures that foster commitment to organizational objectives and “make” managers manage. Four key principles related to a framework for effective governance are suggested for organizations in the public sector:

- **Serving the public interest.** Public organizations must balance management precepts, such as cost effectiveness, with public objectives as stated in legislation and reported to Parliament. An organizational climate that both supports public service values and encourages managing for results can contribute to performance by guiding behavior and motivating effort.
- **Achieving objectives.** The organization needs well-defined outcome objectives, clear performance expectations and reliable indicators to measure progress. It requires the capabilities appropriate to its mission and objectives, including the necessary authorities, people and financial resources.
- **Ensuring accountability.** Clear objectives are key to holding management accountable for the public resources allocated to them. Roles and responsibilities need to be well understood and agreed upon. Performance expectations should be linked to and balanced with capabilities. Reports of what an organization has accomplished should be timely and reliable, to facilitate learning and promote better performance.

- **Appropriate transparency.** Public reporting and public availability of key documents are necessary if organizations are to demonstrate their stewardship of public funds and fulfilment of the responsibilities assigned to them.

No management process can guarantee success, of course. The best it can do is to keep an organization focussed on the goals it wants to achieve and deal with things under management's control that get in the way of success. An effective governance framework is designed to help management do that.

Contracting Activities — a Poor Example for Managerial Discretion

Contracting with outsiders for the purchase of goods and services is one area where government managers enjoy considerable discretion. Unfortunately, as currently practised, managerial discretion in contracting is often a poor example for emulation in other areas.

In this year's audit of sole-sourced contracts for professional services, we found:

- Widespread non-compliance with contracting regulations
- Poor documentation
- Insufficient regard to economy

To succeed, devolution of authority must be coupled with clear performance expectations and reporting requirements. Otherwise, we risk eroding both accountability and performance.

See Contracting for Professional Services: Selected Sole-Source Contracts (1998 Report, Chapter 26).

“Easier said than done,” I can hear some readers say. I agree. In particular, I do not underestimate how difficult it is in many parts of government to establish clear objectives and performance measures, and to report information in an open and frank manner. Nevertheless, as practices in other countries show, we can do more in this area than we are now doing. The potential benefits are worth the effort, especially at this time: structures that promote a performance ethic, reinforced by disclosure practices that facilitate oversight, can minimize the risk of backsliding as short-term fiscal pressures to economize recede.

In the remaining sections of this chapter, I examine different aspects of this challenge.

For related information, see Auditor General publications: Reporting Performance in the Expenditure Management System (1997 Report, Chapter 5); Moving toward Managing for Results (1997 Report, Chapter 11); Crown Corporations: Making Performance Measurement Work (1997 Report, Chapter 22); Crown Corporations: Fulfilling Responsibilities for Governance (1995 Report, Chapter 10).

Innovation and Sensible Risk Taking in the Public Sector

Other sections of this chapter discuss the profound changes — in governance structures, in resources, in service delivery methods — that have characterized the federal public service in recent years. While many of these changes stemmed from the government's fight against chronic deficits, other factors such as globalization, demographic and societal trends, and the technology revolution have made rapid change a fact of life. The competitive and results-oriented environment that now prevails places a premium on the ability and willingness of public servants to take sensible risks and to be innovative — not only to keep up with change, but to lead and influence its direction, and to seize the opportunities that change presents.

There are forces, however, that many observers believe militate against risk taking and innovation. These include the effects on public servants' morale of such interrelated factors as downsizing, the long wage freeze that ended only last year, and a perceived lack of support. At the same time, more openness and a greater level of public accountability for results can sometimes unleash undeserved criticism when results fall short of expectations. In these circumstances, many public servants may feel the most prudent course is to play it safe.

I recognize that the work of this Office is seen by some as contributing to the forces that inhibit innovation. And given the very nature of our mandate, which requires the public reporting of instances where things have gone wrong, there will always be a possibility for our work to have a stifling effect on the willingness of some public servants to innovate and to take risks. Nevertheless, I am convinced that this Office is a relatively small player in the complex operational environment of the public service. We — the public, parliamentarians, public servants and this Office — have to work together to help remove the constraints and find ways to encourage the innovation and responsible risk taking that are required now more than ever.

It was in the light of these considerations that in October this year I sponsored a roundtable discussion on innovation and risk taking among senior managers from the federal and provincial governments, political representatives, and representatives from relevant private sector and labour organizations.* The discussions were based on, and informed by, background papers prepared by the Public Policy Forum (*The Risk Not Taken*), Industry Canada (*An Industry Canada Perspective*) and this Office (*The Role and Perspective of the Office of the Auditor General of Canada*). I believe the attendance at the roundtable, the lively discussion, and the range of views expressed reflect the importance of the topic as well as the interest and concern of the participants. I am particularly encouraged by the fact that participants were able to go beyond identifying problems toward suggesting some concrete steps that may help deal with these problems.

I see the roundtable as the beginning, rather than the end, of an ongoing process. We will continue to work with departments and agencies to identify more clearly the constraints on innovation and sensible risk taking and the actions that can be taken to encourage public servants to discharge their responsibilities with creativity, innovation and integrity.

* A summary of the proceedings of that roundtable is available by contacting this Office.

Modernized Financial Management and Reporting

Encouraging better financial management in the federal government has been one of my priorities as Auditor General since my appointment in 1991. An integral component of good financial management is good financial information. Indeed, accurate and timely financial information is essential to all aspects of public management, from resource allocation and planning to monitoring compliance and evaluating performance. Timely and credible reporting of relevant financial information is also fundamental to holding government departments, and the government as a whole, accountable for the resources they use and the power they wield.

As I look at the state of financial management, I have three key concerns.

Concern 1: Modernization of financial management is long overdue

The need to reform the way the government manages financial information has been on the public agenda for many years. Nearly four decades ago, the Royal Commission on Government Organization (Glassco Commission) called for the adoption of an accounting system that would provide better information on the full costs of government activities. The call has been repeated many times since then from many quarters, both within and outside government.

The government is now in the process of introducing such a system, under an initiative called the Financial Information Strategy (FIS). Among other things, FIS will replace the existing partly cash-based system of accounts with full accrual accounting. This means that spending on capital assets will be recognized as the assets are used up, so that costs will be distributed over the useful life of these assets. Currently, the total cost of a capital asset is charged to expenditures at the time the asset is acquired. By appropriately associating costs with the operations they support, accrual-based accounting will provide us with better information on what government programs actually cost.

Modernizing Comptrollership — Time for Action

Improvements in the government's financial management system are taking place alongside a broader initiative to renew comptrollership in government. In its 1997 report, the Independent Review Panel on Modernization of Comptrollership in the Government of Canada argued that the comptrollership function — the way it is now viewed and practised — must change fundamentally to be appropriate to the needs of modern government.

The Panel put forth the following indicators for ascertaining whether modernization of comptrollership has taken place:

- The availability of government-wide performance standards, appropriately implemented to the circumstances of the separate departments
- The provision of comprehensive and credible performance information to decision makers
- The existence of centres of excellence for the training of managers and professionals in the requirements of comptrollership.

The government has accepted the recommendations of the Panel. I support the Comptroller General's efforts to implement them expeditiously.

Modernization of the government's financial management is long overdue. FIS itself was originally approved by Treasury Board in 1989 and was re-endorsed as a government priority in 1995. But implementation has been slow.

Although progress has accelerated recently, we are still years away from having a financial management system that would meet acceptable standards in the private sector. Further delay is not an option: the government needs financial information that it does not now have.

Concern 2: Government plans would create inconsistencies between parliamentary appropriations and government expenditures

As we reported in September, a key challenge of FIS will be to persuade departmental officials to use the new financial information in their day-to-day management of programs and activities. This is more likely to occur if funds are also appropriated on a full accrual basis. Announced government plans entail full accrual accounting for the annual Budget, the Public Accounts of Canada, departmental Reports on Plans and Priorities and departmental Performance Reports, but not for the Estimates submitted to Parliament for appropriation purposes.

In my view, this fissure in the structure of financial reporting could seriously impair the effectiveness of FIS. Commitment to accrual principles of accounting and budgeting would be lessened among program managers if those principles were not used for so basic a purpose as the granting of supply. It would also needlessly complicate the accountability regime by maintaining essentially two sets of books for the same activities, one for managing and one for reporting. Full benefits from FIS will not be realized unless it encompasses the supply process, so that the information used by public sector managers to plan and run programs is the same as that used by Parliament for purposes of resource allocation and approval.

Concern 3: The government's commitment to objective accounting standards needs to be reaffirmed

For me, one of the most encouraging aspects of FIS is the stated intention to follow accounting principles that accord with the recommendations of the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. These standards are developed openly, with full participation from the financial, accounting and public sector communities, and after due process that involves circulating exposure drafts and evaluating responses from interested parties.

Yet for three years running now, I have expressed concerns about the government's failure to comply with PSAAB standards in recording certain expenditures in the Public Accounts. Because of this, I have been obliged to qualify my opinion on the government's annual financial statements in each of the past two years. The expenditures in question included transitional assistance in 1996 for harmonizing provincial sales taxes with the GST, and funds to establish the Canada Foundation for Innovation in 1997 and the Canada Millennium Scholarship Foundation earlier this year.

Compliance with accounting standards recommended by an independent authority, like the PSAAB, should be the general practice in government accounting. Accounts so prepared are likely to represent the consensus of financial, accounting and public sector experts on how best to reflect financial reality in

government financial statements. In addition, because they will not be tainted by suspicion that the method followed was chosen for political or partisan advantage, the resulting reports will have greater credibility both among citizens and in the national and international financial communities.

The recent Asian financial crisis attests to the importance of transparent, fair and complete information on the financial condition of governments. The International Monetary Fund identified lack of transparency as a contributing factor to that crisis. Opaque reporting practices and limited availability of data obstructed a realistic view of economic fundamentals in the countries now embroiled in economic troubles. Understandable, timely reporting of useful information contributes to better performance, by supporting informed decision-making and exposing the activities of government to the discipline of public scrutiny.

For related information, see Auditor General publications: The Financial Information Strategy: A Key Ingredient in Getting Government Right (1998 Report, Chapter 18); Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards (1998 Report, Chapter 9); Financial Management: Developing a Capability Model (1997 Report, Chapter 2); Management of the Government's Accounting Function: A Central Agency Perspective (1997 Report, Chapter 3). Other publication: Observations by the Auditor General (Public Accounts of Canada, Volume 1, Section 1, 1996 to 1998).

Better Integration of People Management with Ongoing Public Sector Reforms

One of the biggest challenges of the post-deficit era concerns the people of the public service and how they are managed. For government to function properly, Canada needs a strong public service. If government organizations are to innovate and deliver high-quality services to taxpayers, the public service needs to attract and retain talented people. And this valuable resource needs to be managed properly. This takes an effective blend of tangible elements, like good policies and systems, and less tangible elements, like strong leadership.

As I speak with senior government officials, I find much dissatisfaction with the current state of human resource management in the federal government. I have noted — as have other observers and government officials — that the public service is an institution under significant stress.

Dissatisfaction with existing human resource management is also reflected in the interest among government officials in alternative service delivery mechanisms. One of the driving factors has been that present staffing, classification and compensation systems are too unwieldy and inflexible. The government needs to ensure that the rush to get “outside the system” does not divert attention from “fixing the system”.

Managing the work force after downsizing is a significant challenge. Our audits of the government's implementation of expenditure and work force reduction, reported last April, highlighted the need to ensure that work force capabilities match future demands. Early departure incentives often were not targeted with a clear idea of which types of employees would be needed in the future. The adjacent box lists a number of other issues that our audits identified as needing corrective action.

Key people management issues that need addressing

- Modernized and simplified job classification and evaluation systems
- Improved mobility and career opportunities through training, hiring and transfer processes
- Rejuvenation and renewal of workforce to deal with loss of experienced staff and need for new skills
- Shortages in specialized groups (computer specialists, engineers, statisticians, etc.)
- More attention to the situation of employees who remain

It is troubling that these various problems still besiege us. It is not for lack of consensus about the need to change. It is not because the problems have only recently been recognized — the work force reductions have merely amplified issues that have existed for many years.

The elimination of the pay freeze last year has removed a major irritant and source of malaise among public servants. A host of initiatives aimed at revitalizing the public service are also under way, notably *La Relève*. But one has a sense that progress is slow, in part because there seems to be no overall vision of the role and makeup of the public service in a reorganized government sector.

Defining that vision requires answers to some difficult questions. Should the public service be managed uniformly, or should different parts of the public service be managed differently? What should be the respective roles of the central agencies and departments? How best can the principles of merit and political independence be protected? But difficulties notwithstanding, defining that vision and reforming the public service are crucial to the success of the new public sector model the government is trying to create. Unless the “people” problems are solved, the chances of successfully implementing other public sector reforms cannot be rated high.

For related information, see Auditor General publications: Expenditure and Work Force Reductions in the Public Service (1998 Report, Chapter 1); Expenditure and Work Force Reductions in Selected Departments (1998 Report, Chapter 2).

Open and Meaningful Accountability to Parliament

One of the main responsibilities of Parliament is to hold the government accountable: to scrutinize the work of departments and agencies and to force the government to defend its policies and its handling of the public purse. To do this job effectively, parliamentarians need timely and relevant information on government objectives, expected results and actual performance. Information presented to Parliament also becomes available to the public at large, contributing to a citizenry that is better informed and better able to participate in the government process.

Significant steps forward have been taken recently in this area. The annual Performance Reports in the fall and the spring Reports on Plans and Priorities are prominent examples. These are initiatives designed to improve the information available to Parliament and to provide greater opportunity for input into public policy and public management.

It is too early to judge the success of these initiatives. I expect that the quality of the information reported will improve over time, as we learn by doing and as commitment to results and performance becomes more firmly established. Parliamentarians can speed the process along by making effective use of that information. The greater the interest they show in these new departmental reports, the greater will be the incentive for departments to improve their quality. Better information should contribute in turn to better management, by facilitating input from a broader cross-section of stakeholders and by stimulating public servants to focus on results that matter to Canadians.

Alternative service delivery arrangements present a special challenge

As the government re-evaluates its role in order to live within its means, it is increasingly resorting to non-departmental mechanisms to deliver services. These alternative service delivery (ASD) mechanisms take many forms, from special operating agencies within government to partnership arrangements with other levels of government or non-government participants, to commercialization of services. While the general concept is not new, the government has turned increasingly to ASDs to deliver services traditionally provided through departments.

ASD arrangements are generally more specialized than departments and enjoy more autonomy in the use of human and financial resources. Government control is normally exercised through more explicit framework agreements that specify performance targets and measures, and provide for less ministerial discretion. The overarching aim in all of these arrangements is to improve service delivery by vesting the delivery agency with greater flexibility and better incentives, while still maintaining adequate control over the use of public funds.

Whatever the form of the agency used to deliver a service, when it involves federal resources and authority Canadians have a right to expect accountability through full and fair reporting to Parliament. By moving outside the traditional departmental model, new delivery arrangements could, if not properly set up, dilute accountability and weaken public service values. Experience in other jurisdictions shows that maintaining accountability and cohesion in these arrangements is a persistent challenge.

To assist Parliament, my Office has proposed a four-point framework for assessing proposals for new delivery arrangements, mirroring the four key principles of effective governance discussed on page 11:

- **Achieving objectives.** Is the new organization likely to provide better service? Would it meet its objectives in a cost-effective manner and without undue negative impacts?
- **Accountability.** Does the arrangement, in its use of federal resources and authority, make adequate provision for accountability to the responsible minister and to Parliament?
- **Transparency.** Does the mechanism ensure that Parliament and the public will receive key information?
- **Protection of the public interest.** Does the arrangement adequately recognize and protect the essential federal public policy purpose?

ASDs offer the promise of more efficient and responsive delivery through arrangements that are more focussed, flexible and client-centred than is often the case in traditional departments. At the same time, they may entail significant changes in the roles and responsibilities of ministers and in the relationship of service providers with central agencies and Parliament. These changes, in turn, raise important questions about how to integrate ASD activities with the rest of the public sector, how to maintain accountability to

Parliament and how to ensure that the public interest is being served. These questions need to be effectively addressed for the promise of the ASDs to be fully met.

For related information, see Auditor General publications: Assessing Alternative Service Delivery Arrangements (Discussion Paper, June 1998); Creation of Canadian Food Inspection Agency (1998 Report, Chapter 12); Reporting Performance in the Expenditure Management System (1997 Report, Chapter 5); Transport Canada — The Commercialization of the Air Navigation System (1997 Report, Chapter 19).

Conclusion

Over the past few years, government spending and public sector reform have been driven largely by the need to reduce the huge fiscal imbalances that often threatened to push public finances to a crisis point. Strong incentives to be cost-conscious and frugal were naturally present in those circumstances. With the elimination of the deficit last year, these pressures have manifestly lessened.

In this new environment, where paying heed to efficiency and economy may no longer seem as pressing, the countervailing pressures that a good system of public sector management and reporting can bring to bear take on new importance. Elements of such a system include:

- a budget process that reminds us to take the long term into account;
- internal governance frameworks that promote openness and good performance;
- a public service culture and incentive structures that encourage innovation, creativity and continued attention to the public interest;
- accounting and information management systems that yield sound information for key decisions on the allocation and management of resources;
- effective integration of people management with other public sector functions, to ensure that the work force needed to support planned reforms is available and to accommodate worker concerns about those reforms; and
- an open and meaningful accountability regime that gives Canadians assurance that their views matter and that their tax dollars are used wisely.

Under the prod of tight resource constraints, much progress has been made in streamlining federal public administration in recent years, rendering it more efficient, responsive and transparent. The challenge now is to build on that progress, by creating new forces to sustain the momentum for improved performance. The challenge is difficult, but critical. Success entails more than giving taxpayers value for money, though it obviously does entail that. It means building a better country and a healthier democratic society. Improving public sector performance can help restore confidence in government — confidence that has eroded seriously after years of disappointed expectations. Continued over time, it will mean increasingly more effective government and stronger public institutions for our children and our children's children.

Chapter Supplement: Other Recent and Ongoing Audit Issues

Audit Assessments of Performance Information

For the first time, my Office is required by legislation to provide an assessment of the performance information reported by a new service delivery agency, the Canadian Food Inspection Agency (CFIA). Similar legislative requirements are envisioned for two other proposed service delivery agencies: the Canadian Parks Agency and the Canada Customs and Revenue Agency.

The *Canadian Food Inspection Agency Act* requires me to assess the fairness and reliability of the performance information included in the Agency's annual report against the objectives established in its corporate business plan. My first assessment was included in the Agency's annual report this year. The purpose of providing an independent assessment is to add credibility to the information reported by an organization about its performance.

This first assessment provided a good learning experience for both the Agency and my Office. We have seen an increasing interest in this form of assurance in some provinces and other countries. As I have indicated before, I am willing to consider more of this type of work if it is found useful to Parliament and the government.

I recognize that performance reporting is still developing in federal departments and agencies. In my view, more rapid progress toward better reporting is essential; Parliament and the public cannot be expected to wait long for good reporting to become the norm.

I will continue to press for better reporting and accountability and to contribute, wherever possible, to its achievement. Parliament and ministers have an important role to play too: meaningful performance reporting in other jurisdictions has often been achieved only after concerted pressure from political leaders.

For related information, see: Auditor General's Assessment of Performance Information (1997-98 Annual Report, Canadian Food Inspection Agency).

Ensuring Organizational Integrity in Revenue Canada

Ethical conduct in the public sector is a theme of continuing interest for our Office. In 1995, we reported on work we had done on the subject of integrity in government. The objective was to increase the clarity of core principles of ethical decision-making. The study proposed a framework for ethics in government based on the premise that "public service is a public trust."

In September of this year, we reported on how Revenue Canada promotes integrity among its employees. Our audit found that the Department recognizes the importance of a strong ethical culture to its success, and has adopted a number of measures to nurture a working environment supportive of an ethical culture. In addition to common procedures for investigating misconduct, disciplining offenders and correcting identified deficiencies, these measures include:

- incorporation of integrity and fairness among the principles in the Department's vision statement;
- dissemination of written codes of conduct to all staff; and
- training in the behaviour expected of employees.

These measures are consistent with the framework proposed in our 1995 study, and form a strong foundation for the promotion of integrity in Revenue Canada.

The audit also identified areas for improvement to reinforce that foundation. In particular, the codes of expected conduct could be made clearer and their rationale explained. As well, Revenue Canada could provide an ethics advisor to be available for private consultation and to act as a champion for measures aimed at promoting integrity in the Department.

Having ethical standards in place is not sufficient to ensure ethical performance, but it is a necessary step. Revenue Canada's initiatives in this area provide examples that other departments should consider emulating.

For related information, see Auditor General publications: Promoting Integrity in Revenue Canada (1998 Report, Chapter 15).

Examination of the Requirement to Report Specified Foreign Property

On 19 December 1997, the Governor General in Council, on the recommendation of the Minister of Finance and the Minister of National Revenue, asked me to examine the requirement to report specified foreign property under section 233.3 of the *Income Tax Act*. My report on the examination was tabled in the House of Commons on 5 June 1998.

We concluded that the requirement to report specified foreign property is an appropriate mechanism, within an overall strategy to enhance compliance with the laws that require reporting of foreign-source income and also to provide Revenue Canada with information to verify taxpayers' self-assessments. We also examined alternative mechanisms and concluded that none would be as effective as the existing requirement. It is with some disappointment, therefore, that I note the government has decided to implement a "check the box" alternative (which simply requires taxpayers to answer yes or no to a series of questions, without providing details about their assets). However, the government did accept most of our other recommendations.

This examination also provided us with a unique opportunity to seek the views of Canadians and tax experts abroad on the issue. Many who sent us submissions expressed serious and deep-felt concerns about privacy, economic and investment issues. We studied these concerns carefully and found that many were related most likely to the rates of taxation, the requirement to pay tax on worldwide income and a poor understanding of Canada's tax system, rather than to the reporting requirement we were asked to examine.

For related information, see Auditor General publication: Examination of the Requirement to Report Specified Foreign Property Under Section 233.3 of the Income Tax Act (1998 Report to the Ministers of Finance and National Revenue).

Progress on the Federal Science and Technology Strategy

In a series of reports for the better part of this decade, my Office has been encouraging the government to improve the management of its science and technology activities. The federal government unveiled its new science and technology strategy in March 1996, aimed at promoting scientific inquiry and applying technology in the best interests of Canadians. Our concern at this early stage is that the Strategy may lose its initial momentum, as happened with similar efforts in the past.

For this reason, we reviewed the government's progress to date in implementing the Strategy. In doing so, we kept in mind the messages of our previous work, namely, the need for mission-driven and results-based research, clear accountability and a focus on performance.

Our audit, presented in Chapter 22 of this Report, found that the government has been slow in establishing a new governance system for its science and technology activities and that it has not yet acted fully on its commitments under the Strategy. As a result, the management regime set up to oversee federal science and technology activities is not yet working as intended — that is, ensuring clear priorities, co-ordinated efforts and full reporting on performance.

To ensure that the Strategy stays on track, the government should set out clearly what still needs to be done and provide the necessary leadership to have it done. In an information-based world, getting our science and technology programs right is of paramount importance.

For related information, see Auditor General publications: The Federal Science and Technology Strategy — A Review of Progress (1998 Report, Chapter 22); Federal Science and Technology Activities — Follow-up (1996 Report, Chapter 15); Overall Management of Federal Science and Technology Activities (1994 Report, Chapter 9); Management of Departmental Science and Technology Activities (1994 Report, Chapter 10). Other publication: Science and Technology for the New Century: A Federal Strategy (March 1996).

Millennium Bug Still at Large

The Year 2000 problem, also known as Y2K and the millennium bug, refers to the potential for computer system failures as the year 2000 approaches. The problem stems from the common practice among computer programmers in the past (adopted for cost-saving reasons) to represent a year by two digits only. Computers so encoded will be unable to distinguish the year 2000 from the year 1900. That could cause them to shut down or otherwise malfunction. The potential for widespread disruption from such malfunctions is significant.

In 1997, I expressed concern, based on the results of an audit we had just completed, that government progress in preparing its systems for the Year 2000 had been slow. In a follow-up audit this year, we found that the pace of work on Year 2000 projects has accelerated and much progress has been made. But much remains to be done.

The Treasury Board Secretariat has been conducting surveys of systems in departments and agencies that support many key, mission-critical functions across government. Its most recent survey, completed in June 1998, showed that many systems were falling behind an already tight schedule. Our audit this year found that three of six mission-critical functions we examined remained at risk. I am very concerned that systems supporting many government-wide critical functions are at risk of not being Year 2000 compliant on time.

The Year 2000 problem is one to which solutions cannot be postponed. The government should continue to rank it as a top priority, intensify efforts to update systems to make them Year 2000 compliant, and develop contingency plans to ensure that essential government services are maintained as the Year 2000 rolls in.

For related information, see Auditor General publications: Preparedness for Year 2000: Government-Wide Mission-Critical Systems (1998 Report, Chapter 20); Information Technology: Preparedness for Year 2000 (1997 Report, Chapter 12).

A Strategic Approach to Sustainable Development

Organizations in both the private and public sectors are under increased pressure to improve their environmental performance and to contribute to sustainable development. The federal government has at times driven action in the private sector through its regulatory role; at other times it has played catch-up with practices that have taken root elsewhere.

As the largest single enterprise in Canada, the federal government is in a unique position to lead by example, by improving its environmental performance in areas like procurement, waste management, and the use of water, energy and land.

The government's impact on the environment, however, extends beyond its role as employer and consumer. Its major impact flows from the large number of policy and program decisions that influence the way individual producers and consumers affect the environment. The high clean-up costs and environmental damage at the Sydney Tar Ponds in Cape Breton illustrate some of the consequences of a lack of environmental foresight.

Twenty-eight federal organizations have now prepared sustainable development strategies and tabled them in the House of Commons. Through those strategies, departments are being challenged to take environmental, economic and social considerations into account more systematically across the board — in their policies, their programs and their day-to-day operations.

A year ago I said that a key challenge facing the federal government was to go beyond the rhetoric of sustainable development, and to focus on its practical implementation. The Commissioner of the Environment and Sustainable Development will be reporting on whether departments did what they said they would do.

For related information, see Auditor General publication: 1998 Report of the Commissioner of the Environment and Sustainable Development.

Opportunities for Cost Savings

Improving the efficiency and effectiveness of government activities and cultivating a healthy regard for economy are objectives central to our mandate and to the work this Office does. One way of promoting these objectives is by highlighting specific opportunities for cost savings. The following are examples taken from this year's Report:

- National Defence — Equipping and Modernizing the Canadian Forces — Chapter 3. As part of its renewal efforts, National Defence is seeking ways to improve productivity and lower costs of operations. One option being considered is to reduce the frequency of personnel transfers. According to departmental estimates, this could save about \$100 million per year.
- Federal Laboratories for Human and Animal Health Building Project — Chapter 7. This Winnipeg-based project could have been delivered for at least \$5 million to \$10 million less than the estimated \$176 million it cost to complete.
- 1998 Report of the Commissioner of the Environment and Sustainable Development. Common indicators for reporting environmental performance could facilitate comparisons among departments and provide useful benchmarks for bringing about cost reductions. According to one recent study, implementing energy conservation measures government-wide could yield net savings of \$29 million per year by 2005.

Often our audits also find opportunities for cost savings that, while significant, are not easily quantifiable. For example, in Chapter 16 Management of the Social Insurance Number, we report that there are nearly four million more active Social Insurance Numbers than there are Canadians aged 20 or older. The Social Insurance Number is used as an identifier to verify entitlements to a wide array of social benefits and to assess taxes owed. The amounts involved are so huge (approximately \$100 billion in annual payments for all levels of government) that even a relatively low incidence of fraud and abuse could represent significant costs to governments.

Chapter 1

Expenditure and Work Force Reductions in the Public Service

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Main Points

1.1 Expenditure and work force reductions have affected the public service and public servants for more than a decade. In 1995, the government launched Program Review, an initiative aimed at rethinking and realigning government programs in light of fiscal restraints.

1.2 To better manage expenditure and work force reductions, central agencies moved from imposing, directing and prescribing to providing leadership, guidance and support to departments. For example, instead of adopting the “one size fits all” approach, Treasury Board Secretariat proposed a management and accountability framework to departments and allowed incentive programs to take into account the differences in their context and operational environment.

1.3 Program Review was a success from many perspectives. The deficit has been reduced and personnel costs have decreased for the first time in more than a decade. In spite of a difficult climate, reductions were implemented without major work disruptions; and financial departure incentives have been effective in minimizing layoffs.

1.4 The cost of achieving work force reductions was high, however, not only in dollar terms but in human terms as well. For example, between 1992 and 1997 the government paid incentives to some 46,000 public servants, military and RCMP members to leave or retire. Furthermore, work force reductions have amplified a number of human resource issues, such as the need for rejuvenation and renewal and the need to modernize and simplify human resource systems. Many studies and our own audit work indicate that the public service is an institution under significant stress and that strong actions are now required.

1.5 Significant improvements were made in the management framework put in place by central agencies. Nonetheless, more efforts are needed to improve the management of work force reductions — for example, in critical occupational groups where there might be surpluses in some departments but shortages in others.

1.6 There is a need to improve accountability to Parliament for expenditure and work force reductions, and for the related costs. Roles, responsibilities and accountabilities of central agencies and departments in the management of work force reductions also need to be clarified.

Introduction

Deficits, Fiscal Restraints and Work Force Adjustments

1.7 From the end of the Second World War to the early 1970s, the Canadian economy grew considerably. The growth in the range of social and economic activities of the government significantly increased the size of the public service. One exception was the period from 1958 to 1963, when Canada faced a recession that resulted in sustained deficits and a number of restraint measures, such as freezes on public service hiring.

1.8 In the 1970s, increases in government spending and events such as rising oil prices and interest rates, the resulting slowdown of the economy, the indexation of social programs and the de-indexation of tax made deficits a continuing feature of federal budgets. Recurrent deficits led to a series of restraint measures, including:

- a decision in 1985 to reduce the size of the public service by 15,000 person-years over five years (person-year was the indicator the government used at the time to measure the “consumption” of labour);
- decisions starting in 1991 to reduce the size of the Department of National Defence from 84,000 to 60,000 military members, and a decision in 1994 to reduce its civilian work force from 36,000 to 20,000, both reductions to be achieved by March 1999;
- the freezing of salaries and the suspension of collective bargaining for six years starting in 1991;
- the transfer of the administration of transportation facilities, such as airports, to local authorities starting in 1992;
- a comprehensive reorganization in June and November 1993 that reduced the number of departments from 35 to 23, along with a requirement to significantly reduce administrative costs.

Exhibit 1.1 presents key restraint measures and others introduced over some 30 years that impacted on the size of the public service or otherwise affected public servants.

Exhibit 1.1

Key Restraint and Other Measures That Have Impacted on the Public Service or Public Servants

	1958	
	1967	1958 to 1963
<i>Public Service Employment Act</i> - Layoff authority		Various hiring freezes
1975	1971	
<i>Anti-inflation Act</i>		Waiver of early retirement introduced in the <i>Public Service</i>
1984	1982	<i>Superannuation Act</i>
Expenditure Control Plan		“6 & 5” Wage Restraint Legislation
1985	1986	
• Budget 15,000 person-year cut in 5 years		• Nielsen Task Force Report

- Voluntary Early Retirement Incentive Program offered to management category

1987

1989

- Public Service 2000
- Special Operating Agencies

1991

- Budget wage restraint legislation introduced
- Public Service strike, reasonable job offer introduced, 10% cut in Executives

1993

- *Government Expenditure Restraint Act*
- Public Accounts Committee appearance and response to WFA audit
- Restructuring expects to save \$3 billion over 4 years
- Hiring controls implemented

1995

- Budget (came into effect June 1995, \$16.9 billion savings over 3 years)
- Program Review
- First departmental Business Plans
- Deputy Comptroller General (DCG) survey
- Early Departure Incentive (EDI), Early Retirement Incentive (ERI) in effect, "Most Affected Department" designations, Joint Adjustment Committees established, Management Framework, Direction on managing terms, Direction on alternation
- Privatization and commercialization announced

1997

- Budget
- Deputy Comptroller General survey
- Payback calculations sent to departments, meetings followed
- La Relève

1999

End of Program Review period

Source: Treasury Board Secretariat and OAG

- Work Force Adjustment (WFA) Policy modifications (pay in lieu of notice, training entitlements)

1988

1990

Task forces and White Paper on Public Service Renewal

1992

- Auditor General's audit of WFA
- Executive Employment Transition Policy comes into effect
- DND's armed forces reduction program
- *Public Service Reform Act*

1994

- *Budget Implementation Act* (Program Review announced)
- Auditor General follow-up audit of Work Force Adjustment Directive
- Efficiency review
- DND's Civilian Reduction Program

1996

- Budget (creation of service agencies announced)
- Program Review II, ongoing yearly savings increased to \$9 billion after Phase II
- Deputy Comptroller General survey

1998

- Early Departure Incentive (EDI)/Early Retirement Incentive (ERI) program closures

1.9 To minimize layoffs by redeploying public servants touched by restraint measures, in the 1960s the government approved the Work Force Adjustment Policy. In 1985, it began to use financial incentives to achieve work force reductions by enticing public servants to leave the public service voluntarily. The Policy (renamed the Work Force Adjustment Directive in 1991) and related incentives were modified periodically. One significant modification in 1991 added a clause guaranteeing a “reasonable job offer” to surplus public servants before they could be laid off. “Reasonable job offer” was defined in terms of salary level as well as distance from the employee’s work location. Public service unions viewed the “reasonable job offer” guarantee as tantamount to job security.

1.10 To deal with situations that it believed could not be accommodated under the Work Force Adjustment Directive, the government introduced other directives and departure incentive programs over the years. In 1992, for example, the first of several Force Reduction Programs was approved for the Department of National Defence. It allowed for the cash payment of special leave to non-commissioned members in overstuffed military occupational groups who volunteered to leave. Also in 1992, the government approved the Executive Employment Transition Policy because it was felt that executives could not be guaranteed a “reasonable job offer”. In 1994, the Civilian Reduction Program was approved to permit the Department of National Defence to deal with the reduction of its civilian work force due notably to base closures.

1.11 In spite of all the measures announced by governments, in the ’80s and early ’90s expenditures continued to increase. This led to deficits reaching alarming proportions. A consensus was emerging that the fiscal situation called for different and more drastic measures.

On the Verge of a Crisis: Program Review and Other Reviews

1.12 Program Review focussed on realigning programs in light of fiscal constraints. In 1994, a number of factors threatened the deficit target of three percent of GDP that the government had committed itself to achieve by 1996-97. The unstable fiscal situation meant that initiatives under way took on greater importance. Under the umbrella of a renewal initiative called “Getting Government Right”, the government launched a number of reviews. One of these was Program Review, which consisted of the scrutiny and review of “program spending” (non-statutory spending representing some \$50 billion of government expenditures out of a total of some \$160 billion) and a re-examination of the federal government’s role and responsibilities in delivering those programs.

1.13 Program Review asked ministers and their officials to submit programs to a test of six primary questions:

- Does the program or activity continue to serve a public interest? (public interest test)
- Is there a legitimate and necessary role for the government in this program area or activity? (role of government test)
- Is the current role of the federal government in this program a candidate for realignment with the provinces? (federalism test)
- What activities or programs should or could be transferred in whole or in part to the private or the “voluntary” sector?(partnership test)
- If the program or activity continues, how could its efficiency be improved? (efficiency test)
- Is the resultant package of programs and activities affordable within fiscal restraint and, if not, what programs or activities should be abandoned? (affordability test)

1.14 To assist ministers and departments, programs were assigned “notional” centrally established fiscal targets for expenditure reduction over three years. These were targets that the Department of Finance, assisted by the Treasury Board Secretariat, estimated would have to be met for the government to reach its overall fiscal objective. Central ministerial and deputy ministerial committees were set up and tasked with the responsibility of reviewing plans prepared by individual ministers and their officials. A Secretariat was created in the Privy Council Office to support the work of the committees and advise departments on their plans. Recommendations and decisions on programs that had been reviewed were reflected in the 1995 Budget.

1.15 The Minister of Finance announced in February 1995 that Program Review would result in some \$17 billion in expenditure reductions over three years. This would contribute to a net reduction of \$9.8 billion in federal departmental spending levels between 1994-95 and 1997-98. Many departments saw their spending levels cut by 20 percent or more. It was also announced that Program Review and other reviews, such as policy reviews, would result in structural changes to the public service — for example, the commercialization of air navigation services, the privatization of the Canada Communication Group, the creation of new agencies like the Canadian Food Inspection Agency and others, and the abolition or restructuring of some 120 government agencies. It was estimated that by 1997-98 such measures would reduce the public sector work force, including National Defence and the RCMP, by as much as 45,000.

1.16 Special incentive programs introduced. Among other measures to facilitate departments’ implementation of Program Review and other expenditure reduction decisions, and to minimize involuntary layoffs, the government approved for parts of its work force two special departure incentive programs for a three-year period to end in 1998: the Early Retirement Incentive program and the Early Departure Incentive program. The Early Departure Incentive was offered in exchange for a three-year suspension of the “reasonable job offer” in the “most affected departments”. To be declared “most affected” by Treasury Board, departments had to be unable to meet their work force reductions under the Work Force Adjustment Directive and other existing management measures.

1.17 In February 1995, the government stated that the “cost of the cash-based early departure incentives” would be about \$1 billion. Appendix A summarizes key departure incentive programs used over the years to entice surplus military members, RCMP members or public servants to voluntarily retire or leave.

1.18 Program Review Phase II. By September 1995 there was a general perception that still more could be achieved. Given this perception, and the need to meet further fiscal targets, the government launched Program Review Phase II. However, departments were informed that decisions reached in the first phase of Program Review would not, as a rule, be revisited.

1.19 In the 1996 Budget, the Minister of Finance estimated that Program Review II would result in further expenditure reductions of some \$2 billion by 1998-99. Significant structural changes would also occur through the devolution, privatization or commercialization of government activities, such as the devolution of harbour administration to local authorities. It was estimated that possibly 10,000 jobs would be eliminated, in addition to the previously estimated 45,000 to be affected under Program Review I.

Previous Audit Work Performed by the Office

1.20 In November 1992 this Office reported to Parliament the results of an audit of payments made to employees under the Work Force Adjustment Policy (later Directive) from 1986 to December 1991, before the inclusion of the “reasonable job offer” guarantee. We reported that while some departments had managed to reduce their work force cost-effectively, others had not managed payments to employees with the same due regard to cost effectiveness. We also noted that payments had been used for reasons other than those specified in the Policy.

1.21 The Office concluded that central funding, inadequate information and ineffective controls in central agencies and departments had led to a gradual deterioration in the management of financial incentives. Many public servants perceived such incentives as normal entitlements upon retirement or upon leaving the public service. In our 1994 follow-up, we reported that a number of initiatives aimed at addressing those issues were at various stages of implementation.

Focus of the Audit

1.22 The objectives of our audit were:

- to determine the extent to which announced targets for expenditure reduction or, where specified, work force reduction have been or are likely to be achieved;
- to identify the cost of work force reductions and determine the extent to which the initiatives resulted in savings;
- to assess the extent to which departure incentive programs were managed in accordance with relevant policies, directives or guidelines; and
- to identify lessons learned for possible application in the future.

1.23 This chapter reviews the evolution of expenditure and work force reductions over the years and provides a global assessment of the results, with an emphasis on the management of expenditure and work force reductions announced since 1995, pursuant to Program Review and related initiatives. It focusses on central agencies (Department of Finance, the Treasury Board Secretariat and the Privy Council Office) and the extent to which they provided clear direction to departments or put in place a management and accountability framework for cost-effective implementation of reductions and for achievement of overall results. Chapter 2 examines the implementation of expenditure and work force reductions in a number of departments. We did not examine the merits of the specific decisions resulting from Program Review; also excluded was any evaluation of the impact of work force reductions on individuals laid off. Further details on the audit objectives, scope, criteria and approach are presented in **About the Audit** at the end of Chapter 2.

Observations

Different Approaches Yield Different Results

1.24 Over the last three decades, governments have used different approaches to wrestle the deficit and reduce the size of the public service, with varying degrees of success.

1.25 Historically, the response to deficits was simple: let's reduce, cap or limit the growth of expenditures until revenues catch up. The underlying assumption was that deficits were an aberration that would not last. Staffing or salary freezes and across-the-board expenditures and work force reductions are examples of this kind of response. Our review of best downsizing practices revealed that such approaches generally do not result in long-term benefits, as shown by attempts in the late 1970s and mid-1980s to reduce the public service, and by efforts to reduce the size of the executive cadre. Over time, because such reductions are not anchored to changes in structures and

work processes or to decisions to abandon or transfer activities, staff levels are likely to go back to former levels, if not higher.

1.26 The second approach used by governments to tackle deficits and reduce expenditures over the years has been “rationalization”. Reorganizing, streamlining, re-engineering or implementing “total quality” concepts are examples. Public Service 2000, the 1993 restructuring and reorganization of the government, and the *Blueprint for Renewing Government Services Using Information Technology* of 1994 are specific “rationalization” measures taken by the federal government. The underlying assumption is that efficiency gains will help to improve or redress the fiscal situation. What the experience of the public service shows, however, is that rationalization takes time to produce efficiency gains, that efficiency gains may not materialize if projects fail, or that the gains may not be as high as anticipated. Furthermore, rationalization efforts often require additional resources at the front end because operations must continue while the desired transformation is being planned, developed and tested. In the meantime, moreover, the fiscal situation may continue to deteriorate, as federal deficits did in the early nineties. If achieved, however, efficiency gains resulting from rationalization efforts can be long-lasting. In such instances, downsizing is likely to be more permanent although a large number of low-paid jobs may be replaced by higher-paid but fewer jobs.

1.27 The third approach used by governments has been to realign or “rethink” programs with a view to making government more economical, effective and efficient (as the 1984 Nielsen Task Force undertook to do). The underlying assumption is that some activities need to be terminated or transferred and some assets sold in order to protect others judged more important or valuable. The issue is the role of the government, and one of the deciding factors is the capacity to pay. Examples are the devolution of airports and harbours and the privatization of Crown corporations. In such instances, although other issues may arise — the issue of accountability, for example — work force reductions are more likely to be permanent since the government no longer performs the function.

1.28 The importance of selecting the right target. Over the last two decades, attempts by government to reduce expenditures and the size of the public service have focussed on person-years, positions, indeterminate employees, reporting levels or salary expenditures. Exhibit 1.2 shows that from 1985 to 1995, attempts at reducing personnel costs — such as salary freezes or the 15,000 person-year reduction announced in 1985 — have not succeeded in producing a downward trend in those expenditures; year after year, personnel costs continued to increase, although at a lower rate. Some of the reasons for the slow but continued yearly growth include the introduction of new programs, resulting in hiring that offset work force reductions made in other programs; the increased professionalization of the public service; and cash payments made to employees under various incentive programs.

Exhibit 1.2 is not available, see the Report

Variations in Personnel Costs for the Government of Canada from March 1985 to March 1997

1.29 Such results demonstrate the importance of choosing the right target and of deciding what, in the end, should be measured. For example, because the focus from 1985 to 1991 was on person-year reductions, there was an increase in forms of employment not subject to person-year controls — such as temporary assistance — even though this was not necessarily cost-effective. For lasting results, the target selected must be sufficiently encompassing to permit managers to make cost-effective choices, such as the most appropriate mix of resources required, and it must be driven by permanent changes in structures, work processes or the nature of programs or activities.

Program Review: Significantly Different from Previous Initiatives

1.30 Our audit work in departments, our review of documentation and our interviews with current or former senior officials reveal that there were significant differences between Program Review and previous attempts to reduce expenditures or the work force (see Exhibit 1.3). Some of the most significant factors that distinguished Program Review include the following:

- From a central agency perspective, Program Review focussed exclusively on reducing expenditures, not staff levels. It was not the government’s objective to reduce the public sector by some 55,000 employees. That number illustrated the magnitude of the impact of the expenditure reduction targets.
- There was a strong resolve at the political level to achieve the deficit target of three percent of GDP and the required expenditure reductions, because there was a broad recognition of the need for urgent action. The credibility of the government in relation to its commitment was at stake.
- Expenditure reductions could be strategic and selective because there were clear, logical and easy-to-understand criteria for the review and prioritization of programs and for making decisions about expenditure reductions.
- Ministers and departmental officials were key players. They were given the responsibility and the flexibility to propose specific areas where revenues could be generated or where expenditures could be reduced in light of overall fiscal targets.
- Ministers and their officials were made more aware of the need to rethink and redesign programs and services and to be innovative because at the outset, “notional” targets and the three-year horizon gave a better appreciation of the magnitude of the total effort required of them.
- Departments were given three years to implement Program Review I and II decisions, with the assurance of some stability in funding. As a general rule, decisions flowing from Program Review I were not revisited.

Exhibit 1.3

Some Key Differences between Program Review and Other Expenditure Reduction Initiatives

- **A strong political resolve.** There was an atmosphere of crisis and, because the credibility of the government was clearly at stake, there was a strong resolve at the political level to achieve the three percent of GDP deficit target and the required expenditure reductions. Global fiscal parameters were clearly understood; the need to reduce the deficit provided focus.
- **A strategic perspective.** The six questions provided a clear, logical and easy-to-understand framework for the review of programs, their prioritization and strategic and selective decision making about expenditure reductions, instead of across-the-board cuts. Guided by the clear objective and the conceptual framework, central agencies and, within central agencies, branches or divisions were able to work more closely together.
- **Clear goal and vision prompting innovation.** Expenditure reduction decisions were expressed in terms of overall expenditures, or “base reference levels”, rather than focussing on reducing positions, person-years or payroll costs. Expenditure reduction targets and the three-year horizon provided by the Department of Finance gave a clear idea of the magnitude of the total effort required by ministers and their officials. This prompted them to rethink, to redesign programs and services and to be more innovative.
- **The direct involvement of ministers.** Program Review was not a centrally driven process. Collectively as well as individually, ministers were directly involved and Program Review decisions were approved by Cabinet or, in a number of cases, the Prime Minister.
- **A special management structure was created.** A special structure was established to manage the process. Two committees were

formed: the Co-ordinating Group of Ministers (CGM) chaired by the Minister of Public Service Renewal, and the Steering Committee of Deputy Ministers (SCDM) chaired by the Clerk of the Privy Council and Head of the Public Service. A Secretariat was created to support the two committees. The committees reviewed the plans proposed by departments and provided guidance and advice. The committees sent a clear message, at the outset, that the fiscal targets had to be met and that if plans came short of that, departments would have to go back and revisit. This was seen as a test of the resolve of the government; people at the centre realized that giving in would have jeopardized Program Review. Some of the discussions with departments nevertheless lasted until the presentation of the 1995 Budget.

- **The process respected differences between departments.** Individual ministers and departmental officials were given the responsibility to propose where, specifically, in their portfolio, programs and services expenditure reductions could occur within the boundaries set by the fiscal targets. Departmental officials had the flexibility to decide where revenues could be generated or how expenditure reductions would be implemented.
- **Effective communications.** Within government the process was open and transparent, sending a message to departmental officials that the new approach was different and that it was not only about expenditure reductions; there were no “surprises”.
- **A reasonable time frame for implementation.** Departments were given three years for implementing Program Review I and Program Review II decisions, with assurance of stability in funding during this period.
- **Decisions were not revisited.** Decisions flowing from Program Review I were firm and, as a rule, they were not revisited.

1.31 A number of areas nevertheless presented challenges or difficulties. The most significant included the following:

- The time frame between the launching of Program Review in May 1994 and the deadline for departments to submit plans (August 1994) was very short. Partly as a result, the “affordability test” was the determining factor driving proposals and eventually decisions. There was not much time for analyzing in detail the potential impact of the cuts proposed.
- Differences in planning assumptions and in the information available at the central agency level and that available in some departments led to sometimes lengthy discussions about the numbers to be used as a base for making expenditure reductions and for setting fiscal targets.
- The responsibility for raising horizontal issues was left mostly with departments. A number of horizontal issues were raised, and some — like the consolidation of responsibilities for food inspection — were resolved. However, other issues were not raised or could not be resolved, like the presence of many government departments in international affairs and in our embassies instead of a more centralized approach, and the roles and responsibilities of central agencies in the governance of the public service and in human resource management. Exhibit 1.4 illustrates some of the challenges or difficulties associated with Program Review.

Exhibit 1.4

Some of the Challenges or Difficulties Associated with Program Review

- **A short time frame to submit proposals.** The time frame between the launch of Program Review (May 1994) and the deadline for departments to submit their proposals for expenditure reductions (August 1994) was short. Thus, there was not much time for analyzing in detail the impact of what was proposed. Not all departments met the deadline. The short time frame resulted in the final test, the “affordability test”, being the determining factor that drove proposals and eventually decisions.
- **Difficulties of setting fiscal targets at the portfolio level.** Fiscal targets for ministerial portfolios were based on perceptions and the experience of central agency personnel; there was no scientific basis for them. As a result, some could be challenged or negotiated. Furthermore, significant differences in information available at the central agency level compared with that available in departments led to at times lengthy and arduous discussions about the numbers that were to be used as a base for making expenditure reductions.

- **Departmental performance varied.** Departments that had launched their own rethinking initiative prior to Program Review were generally better positioned to review their programs within a strategic framework than those departments restructured in June or November 1993. There were also differences in the way that departments applied the six test questions, and the results were uneven, depending on several variables such as the degree of commitment and involvement of departmental officials. Even if departments were asked to look at programs and activities for a more strategic focus and improved co-ordination and integration of programs and activities within their portfolio, such strategic frameworks were generally not developed. There were no specific criteria or predetermined performance indicators that could be used to objectively evaluate the performance of departments.
- **Certain issues were not raised or not resolved.** The responsibility for raising horizontal issues was left mostly with departments, the “centre” intervening only at the request of ministers. Although a number of horizontal issues were raised, and some resolved - such as the consolidation of responsibilities for food inspection - other issues were not identified or could not be resolved, such as the presence of many government departments in international affairs and in embassies, instead of a more centralized approach. Certain functions or activities were not examined, such as the roles and responsibilities of central agencies in relation to governance or to human resource management.
- **Program Review II.** Although decisions stemming from Program Review I were not revisited, the announcement of Program Review II soon after so much effort had been devoted to meet the requirements of Program Review I had some negative effect. More expenditure reductions were required and a 3.5 percent across-the-board cut was imposed on departments and agencies.
- **Renewal initiatives.** While renewal initiatives such as La Relève are seen by central agencies as an opportunity to tackle persistent and emerging human resource issues, they are received with cynicism by officials in some departments still struggling with downsizing issues - partly because human resource issues, such as the need for renewal and rejuvenation, have been made worse by the implementation of Program Review decisions. Furthermore many departments had not integrated such issues in their expenditure reduction plans, or made allowance for addressing them.

The Management and Accountability Framework at the Centre: Significant Improvements

1.32 The changing role of central agencies. Another factor in the difference between previous attempts to reduce expenditures and Program Review has been the changing role of central agencies. For example, central agencies moved from imposing, directing and prescribing to providing leadership, guidance and support to departments, which were made responsible for deciding how and where expenditure reduction would be implemented. Central agencies managed the Program Review process and, within the boundaries of notional targets, they provided peer review guidance and advice to departments. Furthermore, instead of adopting the “one size fits all” approach of the past, Treasury Board allowed incentive programs to take into account the differences in the context and operational environment of departments. If they felt the need, for example, departments could ask to be declared a “most affected department”. In March 1995, 11 departments and agencies were designated “most affected departments”. As of March 1997, there were 17 such departments and agencies.

1.33 A number of tools and mechanisms were put in place. In response to our 1992 Report chapter, which was critical of the management and administrative frameworks at both the central agency and the departmental levels, the Treasury Board Secretariat developed an accountability framework for the management of work force adjustments as well as a number of measures and tools. The tools include, for example, a manager’s guide and an audit guide on work force adjustments. Periodically, guidelines and clarification were issued dealing with areas such as post-employment or contracting with former public servants.

1.34 Committees were created, including union-management committees. A number of committees were created such as the National Joint Adjustment Steering Committee; the Committee of Departmental Work Force Adjustment Co-ordinators; and the Joint Adjustment Committees composed of management and union representatives. The purpose was to ensure a better management of work force reductions across the public service. Our interviews and a review of their activities revealed that Joint Adjustment Committees, especially outside the National Capital Region, have greatly facilitated the placement or relocation of public servants. For a number of reasons, this mechanism has not worked as well in the National Capital Region. We noted that Joint Adjustment Committees outside the National Capital Region have facilitated the application across departments of the

alternation process (also known as “swapping”). This process permits public servants who want to retire or leave the public service to switch jobs, subject to management approval, with employees who have been declared “affected” but wish to remain in the public service. Since 1995, some 2,600 “swappings” have been reported by Joint Adjustment Committees. People we interviewed who have been associated with the work of these committees said that it has improved union–management relationships significantly; in their view, this concept could be used to address other human resource issues, such as training and mobility.

1.35 A management and accountability framework was proposed to departments. In December 1995, the Treasury Board Secretariat proposed a management and accountability framework to assist departments in the prudent and cost–effective management of the Early Retirement, Early Departure and other incentive programs and related expenditures. Included in this framework was a requirement for an audit of the administration of the program in midcourse and the provision of accurate, accessible, timely and reliable information, as well as a monitoring framework aimed at ensuring that incentive programs were contributing to departments’ progress toward targets set out in their Business Plans. Other objectives of the framework were to ensure probity and compliance and the monitoring of equity issues that might arise from disproportionate job cuts across occupational or demographic groups. Although some Treasury Board Secretariat officials had suggested that formal agreements with departments would ensure greater accountability, this suggestion was not accepted. It was perceived to be inconsistent with the approach used for Program Review, which was to make departments responsible and accountable for deciding on and implementing expenditure reductions as they considered appropriate in their context.

1.36 A test of cost effectiveness: “payback”. One of the key features of the management and accountability framework was the cost–effectiveness test known as “payback”, which is somewhat akin to the concept of “return on investment”. The Treasury Board Secretariat wanted to ensure by introducing the payback concept that departure incentives would result in downward trends in salary, wages and benefits and that the costs associated with incentives would not be higher than the overall reduction in salary, wages and benefits. As initially defined by Treasury Board Secretariat, payback is the relationship between the costs associated with departure incentive programs and the reduction in salary wages and benefits during Program Review. The costs are to be measured from April 1995 to September 1998 and the reduction generated is to be measured from April 1995 to March 1999.

1.37 The cost portion of the equation used to calculate payback is defined as the incremental costs associated with departure incentive programs but excluding payments for severance and vacation pay. It also includes the cost of the pension waiver for the Early Retirement Incentive program. The other portion of the equation is determined by the reduction in salary, wages and benefits after four years. In January 1998, the Treasury Board Secretariat estimated that incremental costs associated with departure incentive programs (\$3.2 billion) will exceed the net reduction in salary, wages and benefits (\$2.5 billion) at the end of Program Review in March 1999. This is partly due to the lower than expected take–up rate for the Early Departure Incentive and the higher than expected take–up rate for the more expensive Early Retirement Incentive. Treasury Board Secretariat officials had initially estimated that some 4,000 individuals would opt for early retirement; as of March 1997 the number was about 8,000. Some of the reasons for this variation include the introduction of the alternation process (paragraph 1.34), the suspension, for three years, of the 15–week separation benefit as of 15 July 1995 and additional reductions under Program Review II. While officials had estimated that between 13,000 and 15,000 individuals would opt for the Early Departure Incentive where offered, only some 7,500 surplus employees had done so as of March 1997. As part of its monitoring, Treasury Board Secretariat calculated payback for departments and agencies whose departure cost estimates had changed significantly from earlier projections. In calculating payback, the Secretariat refined its initial definition of expenditure reductions to include changes in the employer’s contribution to employee benefit plans. This has resulted in a series of discussions with departments about the methodology used and the usefulness of payback as in indicator.

1.38 We believe that in its concept, payback is not only sound but also essential; we acknowledge the efforts of the Treasury Board Secretariat to provide departments with such a tool. The introduction of this concept was

consistent with best practices and with comments we made in our 1992 Report. At that time, we noted that one of the reasons why payments to employees under the Work Force Adjustment Policy were not managed cost-effectively was that managers had no information about the total cost to the taxpayer of such incentives. Individual decisions to grant the incentives simply did not take costs into consideration. In our opinion, a cost effectiveness indicator or measure such as payback can, when effectively designed, provide additional information to a decision to grant departure incentives, while providing managers with strong motivation to give more attention to the need for balancing costs and savings.

1.39 Nonetheless, to improve payback as a monitoring tool and as a measure of cost effectiveness, in our opinion a number of issues in its design and application need to be addressed to make it more relevant and more useful:

- Payback is essentially a financial indicator and is very limited in its ability to provide an assessment of the overall quality of the management of incentive programs; other factors or indicators must also be taken into account. In their own midterm reviews and in the course of our audit, departments raised concerns about the applicability of payback as a measure of cost effectiveness.
- Introducing payback at the same time as the incentive programs would have made managers more aware of the necessity to balance costs and savings. We noted that payback was formally introduced in December 1995, months after departments had approved incentives for a significant number of employees.
- To be held accountable for the prudent and cost-effective management of incentive programs, departments would have needed an understanding and acceptance of the objective, purpose and parameters of payback before it was formally introduced. Our examination of departmental midterm review reports indicates that the application and usefulness of payback were not always well understood.
- The relationship between the costs of incentive programs and the savings they directly generate needs to be clear. As currently calculated, payback makes no distinction between reductions in salary and wages generated by each of the departure incentive programs and those generated by natural attrition, the creation of alternative delivery mechanisms, and the transfer or privatization of activities. Nor is it clear whether the basis used to calculate reductions in salary wages and benefits should be the “net method” — the reduction in salary and wages between the end of Program Review and the beginning; or the “cumulative method”, in which reductions incurred in each year are cumulated until the end of the period; or the “global method” where reductions in salary, wages and benefits are considered in the context of reductions in overall expenditures. How one defines and calculates reduction in salary and wages can impact significantly on the way one interprets the cost effectiveness of work force reductions during and after Program Review.
- In the calculation of payback, a mechanism is needed to recognize increases in salary and wages resulting from new program initiatives that, if not taken into consideration, may offset the reduction in salary and wages and result in a longer payback period than expected.
- Some significant incremental costs associated with, or arising from, work force reductions need to be factored in. For example, incremental severance paid to employees because severance entitlements are higher for employees whose service is terminated than for those who leave of their own volition should be included, because they can be significant (Appendix A). In our 1997 chapter, Transport Canada — The Commercialization of the Air Navigation System, we estimated that 28 percent or \$31.5 million of the total estimated \$112 million in severance costs were because severance was paid out at the layoff rate.

- If payback is to be calculated over a set period of time, as it is now, the impact of the timing of incentive payments on the ability to generate a reduction in salary wages and benefits within that period needs to be considered.

1.40 Information needs to be improved further. In response to our 1992 audit and our follow-up in 1994, the Treasury Board Secretariat and the Public Service Commission made efforts to improve central information systems so the administration of the various financial incentives could be monitored more effectively. The quality of information has improved, but we found in particular that the reconciliation and consolidation of departure incentive information — such as costs of incentives and numbers of recipients, originating from a variety of sources — need to be improved to provide for more effective monitoring and improved accountability.

1.41 Some of the difficulties we have noted are structural. For example, the Department of Finance's responsibilities in the budgetary process and the Treasury Board's responsibilities for financial management apply to the public sector as a whole, which includes more than 90 entities (including military personnel and RCMP members). Treasury Board's responsibilities as the Employer apply only to the public service, which includes some 60 organizations (and excludes military personnel and RCMP members). In other words, some agencies or categories of personnel are included in one universe but not in the other. As a result, information on the costs of incentives that appears in the Public Accounts and the Financial Statements of the Government of Canada cannot be reconciled easily with information reported by Treasury Board on the number of incentive recipients and on public service work force reductions. Moreover, the universe of the Public Service Commission, the agency responsible for assisting departments with the placement or redeployment of surplus employees, is different yet again. Finally, information on the costs of downsizing that was initially contained in the Public Accounts as a Note to the Financial Statements was not included for 1996-97. It is thus difficult to obtain a comprehensive picture of expenditure and work force reductions and the associated costs in the public service and in the broader public sector. Appendix B presents a schematic view of the work that was required to reconcile and analyze information for the purpose of this audit.

1.42 There are other difficulties with the purpose, sources and timing of the information. For example, the Comptroller General obtains information on incentive recipients directly from departments, while the Human Resources branch of the Treasury Board Secretariat extracts information on recipients from central information systems such as the pay system. For the seven departments we selected for a more detailed examination (see Chapter 2), the discrepancy between the information available in the department and the information available to the Treasury Board Secretariat from March 1995 to March 1997 was eight percent or more. No reconciliation of these numbers has been performed.

1.43 Little or no information available in Performance Reports of departments or central agencies. We reviewed a sample of departmental and central agency Performance Reports for the year ending 31 March 1997. We found that they provide Parliament with little or no information on the extent to which incentives have been used, their costs, and savings that resulted.

1.44 Consistent with the views expressed in our 1994 Report chapter, Information to Parliament, we believe that expenditure and work force reduction initiatives lend themselves to a special report that would provide information on costs, savings, staff affected and so on for the government as a whole, and for the public service.

1.45 We believe that overall, in spite of the shortcomings we have noted, the framework put in place by central agencies to assist departments in managing and administering work force reductions and departure incentive programs in a cost-effective way represents a significant improvement over the situation in 1992, when central agencies and departments had conducted relatively few audits, reviews or evaluations of the management of work force adjustments. Since 1995, some 50 audits or reviews have been carried out on behalf of the Treasury Board Secretariat or by departments, covering various aspects of expenditure and work force reductions, including the use of incentives. Treasury Board Secretariat officials have informed us that in their opinion, the issues raised in audits

or in midterm reviews did not warrant any specific intervention by the Secretariat. More details on the results of such audits or reviews are presented in Chapter 2.

Results Achieved and Some of the Impacts

1.46 The deficit has been reduced. It has been reported and we have attested that the deficit in 1996-97 was at some \$8.9 billion. This represented 1.1 percent of the GDP. The government recognizes that along with restraint measures, good performance by the Canadian economy and low interest rates have contributed significantly to this achievement. In the February 1998 Budget speech, the Minister of Finance stated that he expected there would be no deficit for 1997-98, and committed the government to zero deficit for the next two years.

1.47 Reasonable assurance that the government has met or is likely to meet the expenditure reduction targets of Program Review. Information contained in the Public Accounts, provided by the government from time to time, or obtained from central agencies and departments that we have audited leads us to a reasonable assurance that, as of March 1997, departments either have met the expenditure reduction targets of Program Review or, assuming no change in expenditures, are likely to meet them in the future. One of the reasons for this assurance is that Program Review expenditure reductions are taken out of departmental budgets at the start of each fiscal year. Another reason is that central agencies have in place a complex tracking system to ensure that expenditure reduction targets flowing from Program Review are met. It must be recognized, however, that the funding of new activities will make it a complex task to compare departmental budgets at the end of Program Review in 1998-99 with those of the base year (1994-95) — as was the case in March 1997, when ministers had to provide explanations to Parliament for why overall government expenditures were higher than previously stated targets.

1.48 The salary and wages envelope has been significantly reduced. For the first time in over a decade, total personnel costs were reduced in 1995-96 and in 1996-97 by a total of some \$3.8 billion, which includes year-end reconciling items. As shown in Exhibit 1.5, however, the salary and wages portion of personnel costs was reduced by \$1.6 billion over the same period. Although the major portion of the reduction in salary and wages was the result of work force reductions, as previously mentioned, the amount also includes reductions due to natural attrition and employees transferred out of the public sector, and the effect of salary/wages paid to new employees hired during the same period (paragraph 1.39). According to the government, as of March 1997, the incremental costs of departure incentive programs represented some \$1.8 billion (Exhibit 1.6).

Exhibit 1.5

Total Reduction In Personnel Costs and Salary and Wage Envelope from 1994-95 to 1996-97 (\$ Millions)

	1994-95	1995-96	1996-97	Total Reduction
Personnel Costs	\$19,155	\$16,747	\$15,358	\$3,797
Salary and Wages Envelope *	\$15,807	\$15,287	\$14,239	\$1,568

* The salary and wage envelope (SWE) is a component of personnel costs and does not include certain types of allowances such as those used to compensate employees for certain expenses, specific duties, or work in isolated locations. In addition, the SWE does not include the employer contributions to various pension and benefit plans.

Source: Public Accounts of Canada and Receiver General of Canada

Exhibit 1.6

Incremental Costs of Departure Incentive Programs Reported by the Government for the Period from April

**1995 to March 1997
(\$ millions)**

	April 1995 to March 1996	April 1996 to March 1997	Total
Cash incentive payments *	\$ 681	\$ 343	\$ 1,024
Government contribution for the pension waiver under the Early Retirement Incentive Program	\$ 507	\$ 250	\$ 757
Total incremental costs	\$ 1,188	\$ 593	\$ 1,781

* Cash incentive payments do not include incremental costs incurred because severance was paid at the layoff rate.

Source: Public Accounts of Canada and the Secretary of the Treasury Board and Comptroller General

1.49 Financial incentives: contributing significantly to the reduction of the work force, but generous overall. Between February 1992 and March 1997, some 46,000 individuals, including military and RCMP members, benefited from various departure incentive programs (Exhibit 1.7). We found in general that incentives offered by the federal government under various programs were relatively generous. For example, research indicates that termination benefits given by some Canadian organizations in the public and private sectors include an average maximum up-front cash payment equivalent ranging from 36 to 59 weeks' salary. In the federal government, they tend to be higher (Appendix A).

Exhibit 1.7

Number of Recipients by Key Departure Incentive Program - February 1992 to March 1997

**Departure
Incentive Programs**

	Period	Recipients	Total Costs Cash Payments ¹ (\$000)	Payment	Source
Force Reduction Program (FRP)	1992-1997	13,846	\$ 470,560	\$ 33,985	from DND; audited
Civilian Reduction Program (CRP)	1994-1996	7,369	\$ 314,483	\$ 42,676	from DND; audited
RCMP - Work Force Adjustment	1994-1997	843	\$ 40,017	\$ 47,470	from RCMP; audited
RCMP - Executive Plan	1995-1997	22	\$ 1,605	\$ 72,955	from RCMP; audited
Early Retirement Incentive (ERI)	1995-1997	7,925	\$ 255,490	\$ 32,238	from TBS Reduction File
Early Departure Incentive (EDI)	1995-1997	7,540	\$ 308,242	\$ 40,881	from DND and TBS Reduction File
Work Force Adjustment Directive (WFAD)	1995-1997	2,257	\$ 56,396	\$ 24,987	from RCMP and TBS Reduction File
Executive Employment Transition Policy (EETP)	1995-1997	264	\$ 20,372	\$ 77,167	from TBS Reduction File
Alternative Delivery Incentive (ADI)	1995-1997	6,030	\$ -	\$ -	1997 AG Report, Chapter 19
Privatization, Canada	1996	422	\$ -	\$ -	1997 AG Report, Chapter 20

Communication Group		
TOTAL	46,518	\$1,467,165

¹ Total cash payments are those payable as indicated in Appendix A but exclude severance, which totaled some \$810 million.

² This amount does not include accrued annual leave and relocation costs paid under FRP, for a total of \$283 million.

³ This amount does not include the pension waiver costs estimated at between \$800 million and \$900 million for this group.

1.50 Our conclusion about the relative generosity of incentives must be balanced by a number of mitigating circumstances and factors that influenced the design and the level of benefits offered. These include:

- the “premium” that had to be paid for the suspension of the guarantee of a “reasonable job offer” granted in 1991 and for the fact that, when first imposed, salary freezes were presented as protection against layoffs;
- the strong desire expressed by Treasury Board ministers to maintain labour peace within the public service, to treat employees in a humane and sensitive manner, and to use the labour bargaining process to arrive at a negotiated settlement if possible;
- the desire to reduce the public service by means other than involuntary termination, so as to minimize layoffs. According to experts, incentives designed for voluntary termination tend to be more generous;
- the foreseen magnitude of the downsizing. Generally, according to research, the higher the number of employees to be terminated, the more generous the severance programs tend to be, particularly in a unionized setting;
- the poor prospect of re-employment for certain employees, due to lack of transferable skills or to other constraints such as working in communities where there is little or no possibility of federal or other employment. Coupled with the desire to treat all employees equally across Canada, this resulted in decisions to use the lowest common denominator in determining the incentives;
- the effect that the incentive programs have on each other, given that there are several programs and that they were introduced or reviewed at different times.

1.51 Our review of best practices also indicates that there are significant differences between the federal public service and the private sector as well as other public services in the way incentives have been used. For example, in some other sectors, financial incentives for voluntary termination are offered for relatively shorter periods of time, after which they become unavailable. This encourages targeted employees to retire or leave as soon as possible, which maximizes payroll savings and minimizes the disruptive effects of downsizing on the organization and its remaining employees. It also avoids creating expectations among employees that such benefits will be normal entitlements upon departure or retirement.

1.52 A significant increase over the estimated cost of incentive programs. In the 1994-95 Public Accounts, the government recorded an allowance of \$2.3 billion for costs of Public Service Restructuring over the next three years, to reflect incremental costs for the cash portion of departure incentive programs and the required adjustment to pension liabilities. In the 1995-96 Public Accounts, the government re-estimated its total costs at \$3.0 billion. In 1996-97 the total costs were again revised to \$3.2 billion. Of this amount, \$1.8 billion is for adjustments to pension liabilities.

1.53 It is not possible to measure the precise extent to which incentives have contributed to savings. The difficulties we have noted — tracking expenditure reductions over a four-year period during which the expenditure base changed significantly, and deficiencies in the design and application of payback and the reporting structure — inhibits a rigorous assessment of the direct contribution the various incentives have made to expenditure reductions in salary and wages.

1.54 The public service has been reduced significantly. According to the Treasury Board Secretariat, from March 1995 to March 1997 the public service (excluding military personnel and RCMP members) saw a net reduction of over 31,000 employees, from 225,619 to 194,396 — a reduction of about 14 percent (see Exhibit 1.8). The number of indeterminate (permanent) employees has been reduced from 194,733 to 164,111, a reduction of more than 30,600 or 16 percent.

Exhibit 1.8

Evolution of Employment Profile in the Public Service March 1995 to March 1997

	At March 1995	At March 1996	At March 1997	Evolution from March 1995 to March 1997
Total number of indeterminate employees	194,733	179,455	164,111	(30,622)
Total number of term and casual employees	30,886	28,522	30,285	(601)
Total number of employees in the public service	225,619	207,977	194,396	(31,223)

Source: Treasury Board of Canada - Employment Statistics for the Federal Public Service

1.55 The profile of the public service has changed considerably. Our review revealed that some occupational groups have been significantly affected by work force reductions, as shown in Exhibit 1.11. The exhibit shows the population of indeterminate employees in each group at March 1995 and March 1997, the net reduction, and the number of incentives paid to employees in the group. It must be noted that work force reductions may affect some departments more than others. For example, as noted in Chapter 2, indeterminate science and technology personnel were reduced in Natural Resources Canada and Environment Canada by 23 percent.

Exhibit 1.9

Occupational Groups in the Public Service Most Affected by Work Force Reductions and the Related Use of Departure Incentive Programs (Indeterminate Employees)

	Population at March 1995	Population at March 1997	Net Reduction (1995-97)	Number of Incentives Paid
Technical Groups				
Air Traffic (AT)*	2,411	11	(99%) 2,400	2,379
Electronics (EL)*	2,560	1,245	(51%) 1,315	1,290
Radio Operators (RO)*	1,292	307	(76%) 985	1,033
Engineering and				

Scientific Support (EG)	6,479	5,188	(20%)	1,291	1,223
Administrative Groups					
Secretarial (ST)	7,590	5,411	(29%)	2,179	1,259
Clerical (CR)	36,664	30,919	(16%)	5,745	5,170
Administrative Service (AS)	14,890	13,168	(12%)	1,722	2,103
Program Administration (PM)	32,997	30,781	(7%)	2,216	2,747
Professional Groups					
Educator (ED)	979	674	(31%)	305	279
Operational or Trades Groups					
General Services (GS)	5,884	3,878	(34%)	2,006	1,820
General Labor (GL)	9,878	7,091	(29%)	2,787	2,286

* These occupational groups have been significantly impacted by the commercialization of the air navigation system.

Source: Incumbent File

1.56 Because of the reported effects of the “brain drain” and shortages in some occupational groups, we have reviewed the use of incentives in the Auditor (AU), Computer System (CS) and Executive (EX) groups to determine the impact on the profile of the group, on natural attrition and the total separation rate (normal attrition and departures with incentives). Separate employers were excluded from our review because they often use different occupational groupings. Exhibit 1.10 provides details of our findings.

Exhibit 1.10

The Impact of Incentives on Auditors, Computer System Specialists and Executives

We compared the fluctuations in the population of indeterminate employees in these occupational groups between April 1994 and March 1997 to assess the full impact of incentives. We have noted the following:

- **Auditors (AU)** The vast majority — some 450 or 94 percent — of the Auditors who left the public service between April 1994 and March 1997 left without an incentive. Although some individuals (30 or six percent) did receive an incentive, they were generally isolated cases throughout Canada or in Ontario. We have noted also that new recruits have dropped significantly between 1994 and 1997 when compared with previous years. There were some 5,100 employees in this occupational group in March 1994 and the same number in March 1997. Incentives did not have a significant impact on natural attrition or the total separation rate.
- **Computer System (CS)** The number of individuals in the Computer System group increased by some 900 from 6,200 in April 1994 to some 7,100 in March 1997. In 1994-95 natural attrition was approximately two percent and below that of the public service. Natural attrition increased to 3.5 percent, that is, above that of the public service, which was at some two percent in 1995-96 and in 1996-97. During the same period, however, some 430 Computer Systems Specialists also received an incentive to leave or retire from the public service. Natural attrition dropped but the total separation rate increased to some six percent. The majority of those who left with incentives were at the CS 2 and CS 3 levels in the National Capital Region. During the same period, some 650 individuals were recruited, mostly at the entry level (CS 1). In October 1997 the government signed a collective agreement that included lump sum payments to entice Computer System Specialists to remain in the public service. Furthermore, it has been reported that as many as 2,000 Computer System Specialists may be required to deal with the Year 2000 issue.
- **Executive (EX)** Between April 1994 and March 1997 the number of Executives dropped by some 600 or 16 percent, from some 3,850 to some 3,250. In 1994-95, natural attrition was higher than that of the public service, ranging from 6 to 15 percent depending on the level. Between March 1995 and March 1997, some 500 Executives left without any incentive while some 650 received incentives. The majority left with an early retirement incentive but a significant number left with an incentive under the Executive Employment Transition Policy (see Appendix A). Natural attrition for the Executive Group dropped to approximately three percent, but the total separation rate was between 7 and 10 percent depending on the level. Between 1995 and 1997, some 80 Executives were recruited externally, many at the EX 1 level.

Source: Incumbent File and Mobility File

1.57 The results of our reviews lead us to conclude that incentives have had a negative impact on natural attrition among executives and computer specialists but not among auditors, although the total separation rate was relatively high. This leads us to believe that the management of work force reductions for critical occupational groups such as Computer System or Executive, where there are shortages in some departments and surpluses in others, may require a more global approach than is used for core occupational groups in any department. For example, the basis for declaring an employee surplus in critical occupational groups could be the lack of work overall, instead of in a specific department. Perhaps special interdepartmental mechanisms could be created to manage the process for critical occupational groups. As mentioned earlier, Joint Adjustment Committees have facilitated the placement of surplus employees among departments in the regions, but this mechanism was less effective in the National Capital Region.

1.58 The age structure of the public service has also been affected considerably, although the average age has remained substantially unchanged. As a group, the public service is now more middle-aged, the result of many older and more experienced employees having opted to retire or to leave the public service at the same time as many younger employees left. In the follow-up to our 1994 audit of the management of scientific personnel, we noted a similar phenomenon. The change in the age profile represents a significant challenge for the future, notably the need to address succession planning and recruitment. Exhibit 1.9 shows the age profiles of the public service in 1993, 1995 and 1997.

Exhibit 1.11 is not available, see the Report

Variations in the Age Profile and the Average Age of the Federal Public Service March 1993, 1995 and 1997

1.59 The employment profile of the public service — that is, the ratio of indeterminate staff to other forms of staff employment — has also changed, but it is not clear whether this will be temporary or lasting. For example, we noted that after an initial reduction, the number of casual and term employees increased. The same trend was noted in the temporary assistance costs for the public sector. A 1995 Treasury Board Secretariat guide on comparing the costs of various approaches to meet the demands for administrative personnel concluded that while temporary assistance, for example, may be cost-effective in the short term, this is not the case over the longer term.

1.60 From 1994-95 to 1996-97, costs for contracting or consulting services increased relative to costs of salary and wages. Contracting and consulting services increased by some 14 percent, while salary and wages decreased by 9 percent. Some \$2.2 billion was spent on contracting and consulting services in 1996-97. Since many factors and variables influence the decision to contract for services, it is not possible to draw any macro-level conclusion about the use of contractors as substitutes for public servants. However, we noted the following:

- In 1995, the Treasury Board Secretariat was sufficiently concerned about certain contracting practices to issue specific guidelines to departments outlining unacceptable practices, particularly those involving contracting for the services of former public servants.
- Although departments were asked to monitor the situation and to include it in the scope of their midterm reviews, a number did not.
- Some midterm reviews or departmental audits identified issues that involved contracting with former public servants. The extent of the problem was not documented in the reports.

1.61 The situation needs to be monitored and studied to determine whether casual and term employment, temporary assistance, consulting and contracting are used in specific cases because they are cost-effective or for purposes that may not be cost-effective, such as to demonstrate savings in salary and wages in order to meet the payback requirements, or to bypass restrictions on hirings.

1.62 Incentives have been effective in minimizing involuntary layoffs. There is evidence that as planned and designed, incentives have minimized involuntary layoffs. Although the Public Service Commission reported that as of March 1997 some 970 employees had been laid off, according to Treasury Board Secretariat officials more than half of these employees had, in fact, been transferred through a devolution of activities to other levels of government, such as the transfer of airports to local authorities.

1.63 Few recipients of incentives are coming back as employees. Generally speaking, there is nothing to prevent employees who received incentives from being rehired or reappointed after a period of time normally equal to the one for which they received an incentive. However, rehiring soon after the payment of an incentive may indicate that there was poor planning or that a surplus situation had not really existed. Given the cost of the incentives to the taxpayer, we would expect rehiring to be minimized.

1.64 Overall, we found that from 1992 to March 1997 some 600 individuals (including military and RCMP members) who had received incentives had returned in some capacity. The majority of employees returning were in the Department of National Defence — military personnel hired as public servants, for example. (More details are included in Chapter 2, which discusses our findings in specific departments.) The majority of individuals were hired back as casual or term employees in the public service, but some came back as indeterminate employees. Casual employees are limited to a maximum of 90 days' employment per contract and to 125 days in a 12-month period. We found 11 cases of individuals rehired who had received more than one incentive. In spite of this, we believe that overall the situation has significantly improved since 1992, when we reported that some 800 out of some 13,000 individuals who had received incentives had been rehired in some capacity.

1.65 Many public servants are interested in receiving incentives. Information obtained from Joint Adjustment Committees indicates that at March 1997, for each of the more than 1,400 public servants officially declared "affected," there were three more who were ready to "swap" jobs in order to become eligible to receive a financial incentive and leave or retire from the public service. This ratio was higher in the National Capital Region: five to one. These ratios are conservative since, for example, the numbers reported by the Committees include only individuals for whom management agreed to approve the swapping if the opportunity arose. Furthermore, in the National Capital Region not all departments agreed to participate in the activities of the Joint Adjustment Committees. Our examination of grievances, periodic complaints received and interviews with some union officials lead us to believe that, overall, significantly more individuals were interested in receiving financial incentives and leaving or retiring from the public service than the numbers reported by Joint Adjustment Committees would suggest. In our opinion, this indicates not only that the incentives were attractive but also that not all is well in the public service.

1.66 A number of issues need to be addressed. Now that the fiscal crisis has in many respects subsided, other mechanisms are being used to deal with outstanding or new issues flowing from Program Review. The special committee structure put in place for Program Review no longer exists. The change process has now been integrated into management systems such as the Expenditure Management System, or is taking place through initiatives such as La Relève, aimed at dealing with human resources issues in the public service.

1.67 Although the formal Program Review exercise will end in 1998-99, we believe that a number of issues have yet to be addressed and that significant efforts are still required. For example:

- It has been recognized that many policy issues must be viewed from a more horizontal perspective rather than simply a departmental one.
- There is a continuing need for better quality and consistency of information on, for example, the costs and cost effectiveness of programs and services or on expenditure and work force reductions.

- Important efficiency issues need to be addressed, which could result in hundreds of millions of dollars in savings. Exhibit 1.12 provides illustrations of areas where efficiency gains have been identified by this Office and by the government.

Exhibit 1.12

Examples of Opportunities for Improved Efficiency

(identified by this Office and by the government)

Cost and expenditure reduction can be attained in several ways, such as work force reductions, privatization and devolution of activities. In addition, efficiency gains, cost recovery and revenue generation can offset the need to reduce expenditures. For instance, having cost savings as a performance indicator has been shown to have a positive impact on cost effectiveness.

Examples of potential for improved efficiency reported in previous audits by our Office

- Opportunity for tens of millions of dollars in savings as part of improvement in the management of the Canada Pension Plan Disability Program, major capital projects and export development activities.
- Potential savings of hundreds of millions of dollars in holding costs, related to improvement in the government's materiel management practices, and savings in cost of travel.
- Potential for the cost recovery of expenditures, as in the case of Parks Canada canal operations.
- Allocation of additional resources to tax recovery in higher-risk areas and to combat tax avoidance.
- Opportunity to increase cost effectiveness by improving risk management associated with large systems under development, and improving use of telecommunications.
- Opportunity to generate additional savings in the millions by giving consideration to contracting-out practices and exposing internal functions to competition in such areas as infrastructure maintenance, translation and fleet management.
- Opportunities continue to exist to further simplify and/or reduce the cost of classification and job evaluation and some of the related systems and practices, such as pay administration.

Examples of potential for improved efficiency identified by the government

The government has also looked at modernizing its operations. Various deputy minister task forces looked at different aspects of public administration, such as service delivery, administrative support and addressing horizontal issues. The following are examples of efficiency issues raised:

- Improved services to clients and efficiency gains by better integrating and grouping of services using the "one-stop shopping" concept.
- Improved integration and efficiency of service delivery by the establishment of better interdepartmental and intergovernmental mechanisms and partnerships.
- Increase in the use of shared systems and practices, in particular for administrative and support systems, which could produce significant savings.
- Reinforcement of project pre-selection criteria including a potential for cost savings.
- A reduction in the number of collective bargaining groups.
- Opportunity for cost efficiency in the order of \$25 million annually in pay and benefits administration, by information sharing and use of information technology.
- Estimated savings of \$250 million over five years in streamlining and improving the procurement and payment process.

1.68 The need to address a number of human resource issues has been amplified. Our audit work for this chapter and our 1997 chapter, *Maintaining a Competent and Efficient Public Service*, as well as the Fourth Report of the Clerk of the Privy Council and Head of the Public Service, reveal that work force reductions made to implement expenditure reductions have amplified or made more evident the need to resolve pre-existing and new human resource issues. There is a consensus on the need to:

- adopt longer-term and more strategic plans for human resources, in order to have the right people with the right skills at the right time;
- modernize and simplify human resource systems, notably the classification and job evaluation system and the collective bargaining and staffing systems, as we reported in 1996 and 1997;
- address horizontal issues such as training, hiring and transfer processes in order to improve mobility and career opportunities. Joint Adjustment Committees (paragraph 1.34) might provide an interesting avenue to address some of these issues;
- address rejuvenation and renewal issues, if the public service is to have people with the skills and experience required for the next century while compensating for the loss of experienced professionals and corporate memory;
- address shortages in such groups as policy analysts, economists, auditors, computer system specialists, financial officers, mathematicians, statisticians and engineers — shortages created by the exodus of high-potential employees and the combination of incentives and increased natural attrition that have depleted the ranks to sometimes below critical levels;
- better manage the situation of employees who remain and who feel less secure after work force reductions and after having had their compensation frozen for six years. This can be done, for example, by redesigning work processes, monitoring increases in workloads and stress levels, and addressing low morale and low motivation;
- find ways to return to a more “normal” situation where incentives are used sparingly. In our opinion, an “entitlement” mentality has been created by some 13 years of departure incentives; many public servants have high expectations of being able to benefit from such incentives upon retirement or upon leaving the public service.

Conclusion

Program Review: A Success from Many Perspectives

1.69 From the perspective of central agencies, Program Review has been a success. The government was able to achieve the significant expenditure reductions it estimated were required, and the process ensured significant buy-in from individual ministers and senior officials because they were given the responsibility for deciding on expenditure reductions within the context of fiscal targets.

1.70 According to senior officials, the exercise has led to a considerable rethinking and realignment of government programs to ensure greater relevancy and affordability. In their opinion, Program Review has contributed to making the new Expenditure Management System more focussed on results and impacts than on inputs, and has contributed to a significant restructuring of the public service.

1.71 In spite of a difficult climate, expenditure and work force reductions were implemented without major work disruptions. Furthermore, employee representatives were involved in many aspects, from negotiating incentives to participating actively in Joint Adjustment Committees. Implementation is reported to have made senior officials more aware of the importance of people and of the need to significantly transform and enhance the way people in the public service are managed. This has led to the candid admission by the Head of the Public Service that there is now a “quiet crisis”, the result not just of recent work force reductions but of years of neglect; strong actions are required to ensure that the public service remains a vibrant institution.

1.72 On the basis of our review and our examination, and when compared with previous attempts, we conclude that Program Review decisions have, up to now, been implemented successfully in many respects. As noted in this chapter and Chapter 2, however, there were also difficulties and shortcomings. Moreover, the cost of achieving work force reductions was high, not simply in dollar terms but in human terms as well. The task of “Getting Government Right” is not finished.

Substantial Efforts Are Still Required

1.73 **The management of work force reductions and departure incentives needs to be improved in a number of situations.** Our audit work in relation to occupational groups, for example, leads us to conclude that more effective mechanisms are required to improve the interdepartmental management of work force reductions in certain occupational groups where there may be genuinely surplus employees in one department but where vacant positions or a shortage of the same skills exist in another.

1.74 Another kind of situation that, in our opinion, calls for improved management of work force reductions is that of an organization whose units or parts differ in the status of management of their human resources — one part for which the Treasury Board is the Employer, for example, and another part that has separate employer status. When positions are vacant and skills are easily transferable, or when some functions in DND or the RCMP, for example, can be performed by military or civilians interchangeably, the work force should be managed more globally and strategically. In our opinion, if such an approach had been followed it would likely have resulted in a more cost-effective use of incentives.

1.75 **Accountability to Parliament for Program Review and related work force reductions needs to be strengthened.** This chapter has highlighted the difficulty of consolidating and reconciling information originating from various sources on work force reductions and the costs associated with departure incentives. We have expressed the view that this limits the government’s ability to account completely and comprehensively for the results achieved.

1.76 Although central agency officials and others consider Program Review quite successful so far, full implementation will not be completed before March 1999. In our opinion, the government’s significant commitments to expenditure reductions and the significant costs associated with departure incentive programs require that the government and departments account to Parliament for the results achieved, in a way that is complete, clear, transparent and appropriate. The rendering of accounts especially needs to include results in terms of the expenditure reductions as well as the costs, the expenditure reductions associated with the various departure incentive programs, and their effects on the work force.

1.77 **There is a need to clarify roles, responsibilities and accountabilities of central agencies and departments in the management of work force reductions.** What Program Review clearly demonstrates is that, within the context of broad direction from central agencies, departments are often in the best position to determine what specifically is needed and should be done to implement government decisions in a cost-effective way. For example, in the context of work force reductions, some departments have negotiated with employee representatives the nature and the level of the incentives required. The role of central agencies, in particular the role of the Treasury

Board and its Secretariat as the Employer, has also been evolving for some time (paragraph 1.32). In our opinion, there is now ambiguity about the respective accountability of departments and central agencies in relation to the cost-effective management of work force reductions. The framework proposed for work force reductions states that departments will be held accountable for the prudent and cost-effective management of departure incentive programs. However, much needs to be done to clarify the roles, responsibilities and accountability relationships at the central agency and departmental levels.

1.78 There is a need for visible and sustained political leadership and involvement in addressing the “quiet crisis” facing the public service. One lesson to be learned from Program Review and its implementation is the importance of sustained leadership and involvement at the political level, if significant change is to take place. Strong political resolve, a clear objective that provides focus, the involvement and participation of individual ministers working closely with their officials — all were essential ingredients in the success of Program Review.

1.79 It is not evident that there is the same visible leadership, involvement, consensus and resolve at the political level to address the “quiet crisis”, and to address public service management issues flowing from expenditure and work force reductions and the rethinking of government programs. Program Review has made it abundantly clear that the ability of governments to successfully tackle a crisis, fiscal or otherwise, depends to a significant extent on the competence and effectiveness of the public service. Various studies and reports, including our 1997 chapter, *Maintaining a Competent and Efficient Public Service*, have pointed to the fact that the institution is under significant stress. What is also clear is that unless strong actions are taken, there is a risk that the public service of the future may not be as capable of providing Canadians and successive governments with the best possible professional, loyal and non-partisan service.

1.80 Our concern is that the ability of public servants to effect significant change is limited, because they have to operate within existing frameworks and the means and resources at their disposal. For example, the current legislative framework does not allow for the significant changes considered necessary by many stakeholders to reform and simplify the staffing system in the public service. Many previous attempts at reforming human resource management in the public service have failed, in particular, because there was a lack of political leadership, consensus, involvement and resolve.

Appendix A: Summary Description of Departure Incentive Programs

Incentive program ¹	Eligibility	Brief benefits description
<p>Work Force Adjustment Directive (WFAD) <i>(From December 1991)</i></p>	<p>This option is available to surplus indeterminate employees.</p>	<ul style="list-style-type: none"> • Severance pay at layoff rates.* • Pay in lieu of unfulfilled surplus period for a maximum of six months' pay. • Separation benefit (one week's pay for each complete year of service to a maximum of 15 weeks). (This benefit was suspended from July 1995 to June 1998.)
<p>Early Departure Incentive (EDI) <i>(July 95 to June 98)</i></p>	<p>This option is available to indeterminate employees (excluding executives) who have been declared surplus in "most affected" departments designated by TBS.</p>	<ul style="list-style-type: none"> • Severance pay at layoff rates. • Lump sum payment of: <ul style="list-style-type: none"> - 39 weeks of pay if employee has less than five years of continuous service. - 52 weeks of pay if employee has more than five years of continuous service. - up to 52 weeks if employee has more than five years of continuous service and is eligible for an unreduced pension. In addition, individuals receive Service Allowance, which consists of up to six weeks of regular pay based on an employee's age and continuous years of employment.
<p>Early Retirement Incentive (ERI) <i>(April 95 to March 98)</i></p>	<p>This option is available to surplus indeterminate employees (including surplus executives) who:</p> <ul style="list-style-type: none"> • have at least five years of pensionable service; • have at least 10 years of employment; • are at least 50 years old but not yet 60 by the time they leave the public service. 	<ul style="list-style-type: none"> • Severance pay at layoff rates. For executives: one week's pay for each completed year of service to a maximum of 28 weeks. • Separation benefit (one week's pay for each completed year of service to a maximum of 15 weeks). (This benefit was suspended from July 1995 to June 1998.) • Pay in lieu for a maximum of six months' pay. • Unreduced pension for employees age 50 to 59 who would otherwise have had their pension reduced by up to 50%.

¹ **Source:** adapted from Treasury Board Secretariat guidelines, National Defence and RCMP documents.

* Severance pay varies according to the reason for separation. For example:

- Retirement = (1 week of pay) x number of years of continuous service to a maximum of 30 weeks.
- Resignation = (1/2 week of pay) x number of years of continuous service to a maximum of 26 weeks.
Nothing paid if less than 10 years of continuous service.
- Layoff = (2 weeks' pay for the first year of continuous service) + (1 week's pay x the number of years of continuous service) with no maximum.

Appendix A: Summary Description of Departure Incentive Programs (cont'd)

Incentive program	Eligibility	Brief benefits description
Executive Employment Transition Policy (EETP) (<i>May 95 to March 98</i>)	This option is available to surplus indeterminate executives.	<ul style="list-style-type: none"> Up to 44 weeks' salary (including severance pay) if the executive has less than 5 years of service. Up to 90 weeks' salary (including severance pay) if the executive has more than 5 years of service but is ineligible for pension or eligible for a reduced pension. Up to 70 weeks' salary (including severance pay) if the executive has more than 5 years of service and is entitled to an unreduced pension.
DND Civilian Reduction Program (CRP) (<i>April 94 to March 96</i>)	This option is available to civilian employees affected by a work force reduction, base/facility closure or relocation of work.	<ul style="list-style-type: none"> Severance pay at the layoff rate as stipulated in the application of the collective agreement. Lump sum payment (12 months of pay, paid in one lump sum upon termination of employment). Cash supplement for those employees with 5 or more years of continuous employment. The combined payments not to exceed 104 weeks. Departure allowance (one week's regular pay for each year of continuous employment to a maximum of 15 weeks or up to \$7,000 training and education option).
DND Force Reduction Programs (FRP) (<i>January 92 to March 97</i>)	Regular force members are eligible for this option based on specific: <ul style="list-style-type: none"> military occupation code; rank; years of service. 	<ul style="list-style-type: none"> Severance pay (one week's pay for each completed year of continuous full-time paid service up to a maximum of 30 weeks or 210 days). Special leave based on all periods of regular force as of commencement of retirement leave. Benefits vary from 90/180-270 days or 60 days if members are in last year of service.
RCMP Work Force Adjustment (RCMP-WFA) (<i>From March 94</i>)	This option is available to regular and civilian RCMP members (except executives and public service employees).	<ul style="list-style-type: none"> Severance pay (2 weeks' pay for the first complete year of service, and one week's pay for each additional complete year, to a maximum of 28 weeks. For employees who joined prior to 18 March 1976 the maximum increases up to 30.4 weeks for persons of 35 years or more regardless of whether they were released under WFA or retired voluntarily). Pay in lieu of unfulfilled surplus period for a maximum of six months' pay. Separation benefit (one week's pay for each complete year of service to a maximum of 15 weeks except substitutes). Waiver of pension reduction penalties for early retirement. The magnitude varies depending on type of member, age and year of service, in accordance with the <i>RCMP Superannuation Act</i>.
RCMP - Executives	Option available for all executives (except public service executives).	<ul style="list-style-type: none"> RCMP does not have a formalized Executive Employment Transition Policy. While its executive packages are determined on a case-by-case basis, the Force has tried to maintain parity with its RCMP-WFAD and the public service Executive Employment Transition Policy.

1

Source: adapted from Treasury Board Secretariat guidelines, National Defence and RCMP documents

Appendix B not available, see Chapter

Schematic View of the Documentation and Information Used for the Audit

(Appendix B not available, see the Report)

Chapter 2

Expenditure and Work Force Reductions in Selected Departments

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Expenditure and Work Force Reductions in Selected Departments

Main Points

- 2.1** As a result of a lengthy period of fiscal restraint and recent expenditure reduction programs, some federal government agencies have been abolished, some departments merged and others reduced in size. It is estimated that the public sector work force will have been reduced by approximately 45,000 employees between April 1995 and March 1998.
- 2.2** We selected seven departments to examine how and the extent to which expenditure reductions have been implemented. These organizations, representing over 170,000 employees, differed in size, structure and reduction targets.
- 2.3** Generally, departments we reviewed met their 1995-96 and 1996-97 expenditure and work force reduction requirements. Given progress to date, we expect that most of them will meet their reduction targets for the remaining two years of Program Review.
- 2.4** We found that ministerial commitment and departmental leadership were evident in setting direction and attaining momentum. Factors such as the size of the reduction, readiness for change and the time available to plan had an effect on departments' strategic planning for reduction. Departmental implementation of reduction was generally rigorous and employees were well informed both prior to and during the reduction process.
- 2.5** Although most reduction targets were met, and overall compliance with work force reduction policies had improved since our 1992 Report chapter, Payments to Employees under the Work Force Adjustment Policy, we found questionable actions in some departments. The need for incentive packages was not always well researched and there was a tendency to call for volunteers prior to identifying positions surplus to requirement. Best practices suggest that an organization should conduct a thorough cost/benefit analysis of alternatives; target incentives to areas where they are needed most; and identify the extent to which there is a need to call for volunteers.
- 2.6** Departments focussed primarily on meeting reduction targets in a timely manner. Less emphasis was placed on cost management. Such factors as the initial lack of necessary financial and human resource information, departments not having to fund entirely the departure incentives they provided, and an unclear Treasury Board Secretariat accountability structure for departmental work force reduction costs contributed to a general lack of cost consciousness in departments.
- 2.7** Throughout work force reduction, departments treated departing employees in a humane and sensitive manner. Departments paid less attention generally to those who remained and to their concerns regarding the loss of experienced and qualified colleagues, the level of workload per employee and future departmental direction. Departments have now entered a period of transition that will require not only adjusting organizational structures and operations but also paying particular attention to ensuring that work force capability meets future operational demands.

Introduction

2.8 Fiscal restraint measures and public sector work force reductions have influenced the development and delivery of federal programs and services for a number of years. However, recent initiatives — for example, the 1993 government restructuring; various policy reviews in areas such as defence, science and technology, foreign affairs and social policy; and Program Review — have reshaped the roles, structures and activities of the federal government to an extent not seen since the period following the Second World War.

2.9 Collectively, these initiatives have led to a significant reduction in the costs of the federal government and the size of the federal public service. The changes have affected in quite different ways the many entities that make up the federal public sector. Some government agencies have been abolished, several departments have been merged, and almost all existing departments and agencies have had their budgets reduced — some very significantly.

Focus of the Audit

2.10 Chapter 1 reviewed the evolution of expenditure and work force reduction over the years, and discussed the role that central agencies played in the implementation of government-wide reductions. This chapter focusses on the way reductions were carried out by selected departments and agencies (hereinafter all referred to as departments). We selected seven departments for detailed audit work: the Canadian International Development Agency (CIDA); the Royal Canadian Mounted Police (RCMP); Statistics Canada (StatsCan); Department of National Defence (DND); Environment Canada (ENV); Human Resources Development Canada (HRDC); and Natural Resources Canada (NRCan). They represent a work force of some 170,000 public servants, military personnel and RCMP members, and they differ both in the size of the reductions they were required to make and the approaches they took.

2.11 Our examination focussed primarily on these seven selected departments. Where appropriate, we relied on reviews or audits carried out on behalf of central agencies or by the seven departments themselves. We also reviewed current studies and reports to identify relevant best practices in both the public and the private sectors in Canada, as well as in other countries such as the United States, Australia and New Zealand. These best practices provided a framework within which to identify lessons learned for the future. We examined the extent to which each department has applied these practices (see Exhibit 2.1).

Exhibit 2.1

Expenditure and Work Force Reduction Best Practices

Leadership

Expenditure and work force reductions require sustained, active and visible leadership. It is essential that managers and employees alike know the reasons for the reductions, the challenges facing the organization, and that the situation can and will be managed with a continuing sense of purpose and direction.

Strategic planning

If lasting expenditure reduction is to be achieved, attention needs to be paid to fundamentally rethinking the organization, its role, objectives, delivery mechanisms, structure, operational capabilities and processes.

Selecting the best approach to work force reduction

Once an organization decides to reduce its work force, a cost/benefit analysis of alternatives is needed to determine the degree to which employee departure incentives should be used. When incentives are used, consideration should be given to: targeting incentives to areas or jobs where cuts are needed most; identifying the extent to which individuals will be targeted or volunteers will be called for; and limiting the duration of the incentive offer.

Implementation

Most organizations create a special structure, team or committee, free from operational distraction, to focus reduction decisions and coordinate implementation activities. These structures are usually under the direction of a senior manager and composed of people with the line and staff knowledge and competencies to ensure progress over a short time frame.

Communications

Reduction initiatives require clear and effective lines of communication between management and staff as well as with other key stakeholders (the Minister, employee representatives, the media and external parties). Information provided and received should be clear, accurate, consistent, and timely.

Treating employees in a humane and sensitive manner

It is essential that management minimize the negative effects of work force reduction on both employees departing and those remaining. Employees departing should be informed as early as possible of their employment termination status, their options and their legal rights. In addition, they should receive necessary transition assistance such as career and financial counselling, training and other personnel services. Managers and employees remaining will need to understand the impact of reduction on their work and workload, and the adjustments planned to address these changes.

Monitoring and measuring progress

Monitoring and evaluation mechanisms are needed to ensure that reduction is progressing as planned; the desired results are achieved in a timely and cost-effective manner; and there is compliance with approved policies and guidelines.

2.12 Our audit focussed primarily on expenditure and work force reductions during the period from April 1995 to March 1997. In the case of DND, however, the audit covered the period from 1991 to 1997 in order to include significant military reduction activities not covered in our 1992 Report chapter, Payments to Employees under the Work Force Adjustment Policy. Our audit of the RCMP covered the period from April 1994 to March 1997.

2.13 Members of the Canadian Forces are subject to different obligations and terms of employment from those governing their public service counterparts. For instance, Canadian Forces members are not protected by the Work Force Adjustment Directive (WFAD) and as a condition of service may be relocated at any time. Nor does the directive protect uniformed and civilian members of the RCMP. Further details are presented at the end of this chapter, in the section **About the Audit**.

Observations

The challenges faced by departments were significantly different

2.14 When Program Review was launched in May 1994, many departments and agencies were already undergoing major changes. For example, a government-driven reorganization in June 1993 necessitated a realignment of policies, programs, activities and systems in several departments. At least one quarter of the cuts to operating budgets were to come from savings in administration. In addition, horizontal initiatives such as the Science and Technology Review and the Social Policy Review were under way, affecting many departments involved in those sectors.

2.15 Many departments that we selected were already facing challenges prior to Program Review. The changes each department was experiencing varied due to such factors as the size and geographic dispersion of the work force, the level of reduction required and the options or tools available to address the needed change. The following gives an indication of the renewal and re-engineering activities under way in each of the selected departments:

- Between 1989 and 1993, DND implemented six budget reductions totalling \$14 billion. This required it to scale back most activities, close installations and reduce military and civilian personnel by 14,000 and 3,000 respectively. In addition, a 1993 review of Canada's Defence Policy brought about an additional budget reduction of \$7 billion. At the same time, several renewal and re-engineering initiatives were under way. Projects focussed on such areas as changes to infrastructure, base closures, functional reviews of headquarters and increased delegation of authority.
- In June 1993, NRCan became a new department composed of the former departments of Forestry and of Energy, Mines and Resources. In addition to reducing administrative overhead, several of its sectors had initiated fundamental reviews of their missions, priorities and approaches. They also were adjusting to the termination of energy megaproject funding as well as some funding agreements with the provinces.
- HRDC became a new department in June 1993, taking in all or part of four former departments. This reorganization brought income support programs together with human resource development programs and linked it all to national economic and labour market requirements. Fiscal year 1994-95 was a year of transition, with organizational restructuring and reforms to the social security system. As HRDC was implementing its Income Security Program Redesign, it was initially excluded from Program Review.
- During the summer of 1993, Parks Canada separated from Environment Canada. This reduced the latter's full-time-equivalent staff by half, and marked the beginning of a significant restructuring initiative. The Department was also changing its structure and focus with the implementation of the Green Plan.
- The RCMP had been engaged in three major change initiatives — reducing its operating budget, restructuring its headquarters operations and redesigning its provincial and municipal policing operations in several provinces.
- In response to a change in Canada's foreign policy, CIDA had been implementing a long-term strategic initiative that entailed reassessing its policy and program direction, streamlining decision-making and delivery processes, changing its relations with stakeholders, and examining better people-management practices as well as cost reduction.
- Before Program Review, Statistics Canada had completed a series of expenditure reductions in 1992-93. It faced a further reduction of 2 percent in its operating expenditures starting in 1994-95, increasing to 7 percent by 1997-98. In addition, it had the challenge of planning and resourcing the five-year cyclical project for the 1996 census. The agency had also developed a corporate planning and monitoring capability that would assist in rethinking program delivery, seeking increased efficiencies and opportunities for revenue generation.

2.16 In addition to previous reduction requirements, the magnitude of required expenditure reductions from 1995-96 to 1998-99 during Program Review varied for each department selected. Exhibit 2.2 summarizes the level of required expenditure reduction for each department to 1998-99.

Exhibit 2.2

Budget Reduction Targets for Selected Departments

(includes Program Review targets and reductions announced prior to Program Review)

	1994-95 Main Estimates (\$ millions)	Reduction Targets (\$ millions)					% Total of 1994-95 Main Estimates
		1995-96	1996-97	1997-98	1998-99	Total	
DND	11,545	(576)	(410)	(1,331)	(447)	(2,764)	(24)
HRDC ¹	3,918	(625)	(511)	(16)	(74)	(1,226)	(31)
NRCan ²	1,012	(25)	(54)	14	(15)	(80)	(8)
ENV ³	737	(47)	(59)	(48)	(17)	(171)	(23)
RCMP	1,197	(32)	(20)	(23)	(59)	(134)	(11)
CIDA ⁴	2,027	(312)	8	(138)	(117)	(559)	(28)
StatsCan	282	(11)	(6)	(7)	(8)	(32)	(11)
Total	20,718	(1,628)	(1,052)	(1,549)	(737)	(4,966)	(24)

Notes:

- ¹ The Main Estimates for HRDC exclude non-discretionary Old Age Security payments and provincial/territorial transfer payments. Funding it receives for administration of Employment Insurance has been included.
- ² Since 1994-95 NRCan has faced significant reductions in its Main Estimates due to termination of sunset programs such as forest resource development agreements and the winding down of megaprojects. These add approximately \$360 million to NRCan's reductions, bringing its total reduction to about 43% of its 1994-95 Main Estimates.
- ³ Environment Canada has also faced significant Main Estimate reductions due to sunsetting Green Plan initiatives, adding approximately \$60 million to its reduction and bringing its total reductions to 31%.
- ⁴ CIDA reduction targets are approximately 80% of the total allocation to the International Assistance Envelope.

Source: Treasury Board Secretariat, 1994-95 Main Estimates Part II and departments

2.17 The options and strategies used to meet reduction requirements varied significantly among the departments examined. Some departments used work force reductions in a significant way to accomplish their expenditure reductions, while others (CIDA and StatsCan) did not use this option to the same extent. Some departments sought to augment their available funds by means of alternatives such as user fees, partnerships with stakeholders or cost-sharing arrangements. However, the possibility of placing greater reliance on such alternatives depended largely on the nature of the department's programs and activities, and its ability to identify willing partners.

Leadership

2.18 Expenditure and work force reductions require sustained, active and visible leadership from senior management. Leadership for change of this magnitude cannot be examined in isolation. It is most often demonstrated as a part of such management responsibilities as planning, communications and implementation, as discussed in subsequent sections of the chapter.

Senior management participation in reduction was evident

2.19 Senior management involvement and participation in expenditure reduction was evident in the organizations we reviewed. Ministers and senior departmental officials (deputies and executive committee members) provided a sense of direction from the outset and maintained momentum throughout the reduction process.

2.20 In all seven departments, deputies played a key initial leadership role in preparing, planning and implementing expenditure reduction decisions. In most cases, they established special task structures — which

reported to the departmental executive committee and were headed by senior executives — to co-ordinate planning and implementation.

2.21 The following are some illustrations of leadership approaches demonstrated in the departments we examined:

- The Deputy Minister of Environment Canada exercised leadership through both a top-down and a bottom-up approach. He and his senior management team at headquarters developed a Department-wide approach to determining how expenditure reductions would be made under Program Review. Assistant deputy ministers, with regional directors general, managed the bottom-up approach to identifying opportunities for reduction.
- Leadership in the RCMP was best demonstrated by the nature and level of the Commissioner's visibility in all major change and expenditure reduction initiatives across the Force. His visible commitment to change and reduction was particularly important as he led a "Shared Leadership Vision". This was an initiative that sought increased manager and employee input and commitment to the RCMP's mandate, its values and, perhaps most important, the changes and reductions the Force was undergoing.
- In Statistics Canada, the Chief Statistician provided clear direction from the start that expenditure reductions were to be achieved through means such as rethinking and streamlining programs, and other efficiency measures. Senior management was committed to handling reduction initiatives in such a way that employee layoffs and departure incentives would be used only as a last resort.
- In HRDC, unlike other departments, expenditure reduction targets, program priorities and roles were determined by the Cabinet. The majority of the Department's operations had been excluded from Program Review before the February 1995 Budget. As a result, HRDC had about four months — from March to June 1995 — to determine how the expenditure cuts would be implemented. Senior management leadership had to be swift and decisive, given the late start. The Deputy Minister and the Associate Deputy Minister oversaw the development of a new vision, work force reduction plans, a review process and timetables, as well as a system to delegate responsibility for work force reduction decisions across the organization.

Strategic Planning

2.22 Effective reduction initiatives require strategic thinking and analysis. Simply reducing the number of staff or the size of the organization is a short-term solution that is frequently followed by the same or higher levels of resourcing in the long term.

2.23 As we have noted in paragraph 2.15, most departments we examined were already, to varying degrees, rethinking their mission and operations prior to Program Review. Some of these departments retained their previous special planning structures to deal with Program Review. Such strategic initiatives and analyses provided an effective foundation upon which to deal with the challenges of expenditure and work force reduction.

Time frame and size of reductions affected the ability to plan strategically

2.24 In addition to the knowledge departments had gained from previous renewal efforts, the Program Review process itself reinforced a strategic approach. Departments and their ministers were asked to answer six strategic questions that would assist in determining the areas proposed for reduction (Exhibit 2.3).

Exhibit 2.3

Six Criteria (Questions) Distributed to Departments at the Outset of Program Review

1. Does the program or activity continue to serve a public interest?
2. Is there a legitimate and necessary role for the government in this program area or activity?
3. Is the current role of the federal government in this program a candidate for realignment with the provinces?
4. What activities or programs should or could be transferred in whole or in part to the private or the “voluntary” sector?
5. If the program or activity continues, how could its efficiency be improved?
6. Is the resultant package of programs and activities affordable within fiscal restraint and if not, what programs or activities should be abandoned?

2.25 Departments also were given three years to implement Program Review. This extended period provided an opportunity to plan and implement reductions more strategically.

2.26 As Program Review began, some departments were better able than others to take advantage of their previous strategic analysis and planning capability. Success was dependent on factors such as the size of their expenditure reduction targets, the amount of time available to plan reductions and the degree of certainty about the extent of reduction. For example, while a short time frame to plan reductions proved advantageous to implementing them swiftly, it also meant that the ability to plan strategically was limited.

2.27 Departments with smaller reduction targets, such as the RCMP, CIDA and StatsCan, were better able than the others to use their previous experience with change. For instance, the RCMP used a set of Force-wide, previously approved reduction guidelines to determine what to cut first. CIDA used its planned work force reductions to adjust the profile of its work force in line with its new policy and program direction. As a result of previous reduction initiatives, StatsCan chose not to use employee departure incentives as the means to meet Program Review reduction requirements.

2.28 The key factor for HRDC was time. Unlike other departments, HRDC had only about four months to plan the \$2.8 billion expenditure reduction announced in the February 1995 Budget. This translated into staff cuts of 5,000 full-time equivalents. This time constraint limited the Department’s strategic options. From the outset, its expenditure reduction became mainly a budget-driven exercise, with priority areas for reduction set by Cabinet.

2.29 Initially there was little understanding of how the HRDC organization would look in the future or the work force skills that would be required. It was difficult to plan, given the uncertainties about the nature of future business lines and about the impacts of initiatives such as the new Employment Insurance legislation, and the new Service Delivery Network involving the closure of about 150 offices across the country. Other emerging changes, such as increased reliance on information technology, overhead cuts in national and regional headquarters and the new labour agreements with provinces, made strategic planning an even greater challenge.

2.30 NRCan and DND, along with other departments, were affected by uncertain final reduction targets. While NRCan benefited from its experience with previous change initiatives, uncertainty about its Program Review I reduction levels rendered planning more difficult during the months leading up to the 1995 Budget. In DND, the management of reduction initiatives was clearly complicated by continually increasing reduction targets and the corresponding difficulty of defining an end-state structure for the Canadian Forces. National Defence was given four different military reduction targets over the first four years of its reduction program (1991-94). The resulting need to change its plans so frequently hindered its ability to take a strategic approach to downsizing.

Selecting the Best Approach to Work Force Reduction

2.31 Organizations may offer departure incentives to employees affected by work force reduction in order to implement the reductions swiftly, reduce the need for involuntary terminations and minimize labour relations difficulties. At the same time, the implications (including cost implications) of decisions must also be taken into account.

2.32 We examined three areas that relate to selecting the best approach to work force reductions: cost/benefit analysis to determine the need for and content of departure incentive packages; accountability for assessing the cost impact of using employee departure incentives; and selecting the best approach to determining who should receive departure incentives.

The need for departure incentive packages was not well researched in some departments

2.33 Between 1991 and 1995, departments accomplished their staff reductions through the Work Force Adjustment Directive (WFAD) and Executive Employment Transition Policy (EETP). For DND and the RCMP, the situation was somewhat different. Although military members were not covered by the directive, DND believed it had a moral obligation to provide its members with terms and conditions of employment comparable with those of its civilians. The reductions required DND to determine the need for separate departure incentive packages in consultation with the Treasury Board Secretariat.

2.34 Although the need for DND's civilian departure incentive program in 1994 was established on the basis of a sound analytical framework, planning for its military reduction initiative suffered from insufficient front-end analysis, costing and definition. In 1991, DND was faced with the need to reduce the Canadian Forces from 84,000 to 76,000 by March 1995. Its original plan was to accomplish these reductions initially by means of natural attrition, reduced recruiting and the application of existing personnel policies such as the release of personnel at the end of their period of employment. Incentive packages were to be used as a last resort if the other mechanisms were insufficient to accomplish the necessary cuts. However, in late 1991 the Department decided to focus more on offering incentives to accomplish its reductions.

2.35 The decision to focus on incentive payments was based, in part, on the need to reduce personnel in specific military occupations and on DND's perception that it had a moral obligation to afford military staff the same benefits as civilian personnel, who had recently been given employment security as a result of the 1991 changes in the Work Force Adjustment Directive.

2.36 We could find no evidence that the incentive payments option was adequately costed and compared with the costs of alternative downsizing strategies. Our analysis, and that undertaken by DND's Internal Audit, indicated that even with reduced attrition, the targeted reductions for the first three years of the program could have been achieved without the 3,600 incentive packages. However, DND has indicated that without the use of incentives, the resulting Forces would not have consisted of the military trades and occupations necessary for operations. Subsequent government decisions in the 1994 and 1995 Budgets to reduce the Canadian Forces to 60,000 by March 1999 resulted in cuts significantly larger than natural attrition and other traditional methods could accomplish.

2.37 The RCMP believed that it would require departure incentive packages for uniformed and civilian members involuntarily laid off as a result of expenditure reductions. Throughout the development of the incentive package, the RCMP consulted the Treasury Board Secretariat, which recommended that the Force benchmark the size of proposed entitlements to other federal government incentive plans.

2.38 Although the RCMP's decision was based on the rationale that involuntary employee departures would occur as a result of reductions, there was limited analysis to determine the extent to which departure incentives

would be required. The RCMP analyzed its traditional tools available to effect reductions but did not prepare a comprehensive needs analysis showing to what extent each of these tools — attrition, recruitment, redeployment, and *RCMP Superannuation Act* provisions to waive early retirement pension penalties — could be used to meet reduction requirements.

Minimizing the cost of using departure incentive programs was not a departmental priority

2.39 Minimizing the cost of using departure incentives was not an initial priority for the departments that we reviewed. A key reason for this appears to be that a portion of the incentive payments, particularly for those organizations deemed “most affected”, was in many instances paid not by the department but through central funding arrangements.

2.40 This is not a new issue. As noted in our 1992 Report chapter, Payments to Employees under the Work Force Adjustment Policy, “Managers made decisions regarding payments in lieu without concerns for cost effectiveness.” The chapter asked whether managers would have reacted differently if they had known the full costs of their decisions, and if their own budgets had had to absorb them. Although we have observed more cost awareness than in 1992, the same question is still relevant today. At the start of Program Review, departments focussed primarily on reviewing their programs, identifying areas for reduction, reducing expenditures, meeting reduction targets on time and maintaining fairness and equity in identifying those who would receive departure incentives, not on the costs of those incentives.

The issue of “payback” was not well communicated or always well understood

2.41 As indicated in Chapter 1, Treasury Board Secretariat established a test for cost effectiveness called “payback” to ensure that employee departure incentive costs would not be higher than the reduction in salary and wages. In December 1995, Treasury Board Secretariat indicated that, as a guideline, each department should recover its departure costs from a reduction in their salary, wage and benefits costs over a period of three years ending 31 March, 1998. Following Program Review II, the period of calculation was extended one year.

2.42 The late introduction of the payback test in December 1995 and subsequent changes to the original payback formula did not reinforce departmental accountability for cost effectiveness. For instance, in December 1995, Treasury Board Secretariat estimated the cost of a pension waiver to be \$100,000. By that date, 64 percent of all employee departure incentives involving a pension waiver had already been approved for affected employees. A year later, the actuarial estimate increased to \$125,000.

2.43 As a result, some departments did not manage rigorously the mix of the various departure incentives and the level of natural attrition. As departments were asked to provide only their reasons for exceeding the payback objective, there was little incentive for them to be concerned about accountability in this area. Departmental managers we interviewed indicated that they continued to have difficulty understanding the concept of payback and their accountability for it.

Volunteering for departure incentives was an accepted departmental practice

2.44 Once work force reduction has been decided on as a means to effect expenditure reduction, public and private organizations follow a number of different approaches. They may:

- call for volunteers and decide which positions to reduce on the basis of employee responses;
- cut specific positions that are considered non-essential to future requirements; or

- use a mixed approach, identifying both surplus positions and employees who wish to leave (volunteers) and then, as a first step, eliminating the positions where there is a match.

2.45 Each of these approaches has advantages and disadvantages. The exclusive use of voluntarism may be seen as the most humane and quickest method to effect reduction, because the people who go are those who want to leave. However, there are numerous disadvantages to using this technique alone. It can create false expectations among employees; there may be a mismatch between those volunteering to leave and the unit or job cuts required; or the organization may lose the best performers, who usually have the least difficulty finding suitable employment elsewhere.

2.46 Voluntarism was used for a variety of reasons. Work force reduction was primarily an involuntary program; that is, its fundamental purpose was to provide departure incentives to employees affected by expenditure reduction. We expected that departments who decided to cut positions and staff would normally identify surplus jobs, grant a departure incentive to the incumbents and then abolish those positions. In situations where a number of similar jobs were affected, departments would consider the use of the mixed approach, matching surplus positions to employees volunteering.

2.47 Some departments we examined (DND, HRDC, NRCan) provided incentives to volunteers. In some cases, the practice was formalized within the organization. In some it was deployed as part of a mixed approach. In others, we identified individual examples of this practice, particularly in executive work force reduction. Several factors have contributed to its use:

- the attractiveness of the financial incentive package offered to employees;
- the additional 15 weeks' cash payment incentive offered by Treasury Board to employees who left before 15 July 1995;
- the use of a system of alternates ("swapping") that allows people who want to leave to swap jobs with people who want to stay;
- the short time frame in which departments had to make reduction decisions;
- the magnitude of the work force reductions required in some departments; and
- the prevailing government objective to ensure peace in the workplace while effecting significant reductions.

2.48 In some departments, we found instances where management did not first identify surplus positions but rather focussed first on employee wishes. For instance, CIDA switched some of its staff who wanted to leave from essential to non-essential positions, which it declared surplus. Those employees were granted departure incentives.

2.49 HRDC approved the departures of the majority of employees who volunteered to leave. At the outset, the focus was on employees, not on positions. The most difficult task for managers was to deny requests for early departures. Our field visit to regional and local offices revealed that there was confusion about work force reduction targets, perceived by managers as "moving targets". In the end, about 600 more departure incentives were given to employees than were required to meet the reduction requirements.

2.50 We estimate the cost of the additional 600 departure incentives to be approximately \$50 million. Normally, the wage and salary savings from employee reductions are used to recover the cost of departmental incentives. In this case, HRDC used the savings from these extra cuts (estimated at \$23 million) to fund other operational

requirements, such as the hiring of additional term employees. From April 1995 to December 1997, the number of term employees increased by 625.

2.51 Some employees who volunteered and were approved for departure had experience and skills that these departments would later require. For instance, in DND, reductions in 1992 and 1993 resulted in shortages in six army combat trades and in vehicle technicians. Increased peacekeeping commitments, as well as inadequate control over the number of applications accepted, contributed to these shortages. A decision in 1995 to approve 1,500 more applications than were required helped to achieve the overall reduction target but resulted in shortages of pilots, naval signalmen, naval radio operators and military police.

Implementation

2.52 Once they have decided to undertake work force reductions, most organizations create a special structure, project team or committee to plan and co-ordinate implementation. Staff of these structures need to be free from operational distractions so they can focus their efforts on the reduction. They are usually under the direction of a senior manager and include personnel from line operations and corporate policy and planning functions.

2.53 In most departments that we reviewed, headquarters set corporate priorities and criteria. Guided by those criteria, sector or field organizations prepared proposals that were reviewed by key stakeholders at headquarters and then reviewed and approved by senior management. Branch and field-level managers implemented the proposals. Several of the departments maintained central implementation teams to facilitate and co-ordinate progress across the department.

2.54 We found that departments generally used existing staff functions in areas such as finance and personnel to co-ordinate and control individual transactions, and to ensure compliance with targets as well as the Treasury Board's Work Force Adjustment Directive. In many organizations, union-management working groups were established to deal with issues stemming from work force reduction initiatives.

2.55 To augment the work of their central teams, decentralized organizations used networks of regional committees. Many of the organizations experienced some initial difficulty acquiring and co-ordinating the necessary financial and human resource information to support work force reduction. As the reduction progressed, however, departments reported improved information systems and reporting.

Communications

2.56 In the climate of uncertainty surrounding any expenditure or work force reduction, it is essential to establish clear and effective lines of communication. A two-way communications strategy is needed to provide employees with accurate and timely information and to receive feedback, questions and concerns.

2.57 Employees need information on the objectives being pursued; management's strategies; how many and in what way employees will be affected; planned arrangements for consultation with employees and their unions; guidelines and procedures that will be followed; and the overall timetable of activities. Employees also need an opportunity to ask questions, contribute ideas and provide frank and open comment.

Communications with employees were well managed

2.58 Departments used a wide variety of communication techniques to ensure that employees were made aware of what was being done, why it was being done and the specific details of various departure initiatives being offered. Employees were given a variety of ways to provide feedback and receive answers to their questions. These

included question-and-answer sessions, and fax or telephone numbers that employees could use to receive personalized counselling or responses to their queries.

2.59 Departments used videos, special bulletins and existing newsletters and magazines to ensure that all staff received a consistent message as quickly as possible. Where individual employees had been identified for potential departure, they often received an individualized package of information and met privately with managers and other specialists.

2.60 In most organizations, senior management visited major centres to deliver the message and respond to questions and concerns, in some cases assisted by union personnel. Some departments ran workshops, focus groups and briefing sessions to both give information and receive feedback.

Treating Employees in a Humane and Sensitive Manner

2.61 Work force reduction has a significant impact on those who leave the organization and those who remain. It is essential that senior management endeavour to minimize the negative effects of downsizing on both groups. It is important that management show genuine concern and understanding for those leaving and provide appropriate transition assistance.

2.62 Management and staff who remain need to understand fully how work force reduction will impact on the organization, how the organization will now function and how their work will change. There is a need to pay particular attention to determining how the organization will adapt to the reduced work force; what changes will be made in the operational processes or work design; what the resulting impact will be on the workload of employees; and their capacity to carry out their responsibilities.

Employees were treated humanely and with sensitivity

2.63 The departments we examined provided good examples of humane and sensitive treatment of employees, particularly those who were departing. Some examples include the use of alternates (“swapping”); virtually no involuntary layoffs (RCMP); a departmental policy emphasizing employee needs and interests as a factor in identifying surplus jobs (HRDC); seminars for managers, dealing with the impact on affected employees; training for employees in stress reduction; and transition workshops and job fairs for those leaving (NRCan).

2.64 We found that given the magnitude of the change required and the short time frame allowed, departments generally placed less emphasis on the needs of employees who would remain, particularly during the period of work force reduction. Managers and staff we interviewed in DND indicated that more support had been afforded to those departing than to those staying. Increased workload has emerged as a common concern of many employees who remain in that Department and in others that we reviewed.

2.65 However, some departments did focus on employees who remained. For example, Environment Canada and Statistics Canada used climate surveys or environmental scans to identify staff concerns and elicit employee input and ideas. HRDC created career centres for both departing and remaining employees. In addition, it conducted a number of studies and surveys. NRCan conducted special seminars for employees who remained.

Monitoring and Measuring Progress

General compliance with Treasury Board rules for departure incentive programs

2.66 Monitoring, reviewing and evaluating results achieved is an important ingredient of effective expenditure and work force reduction. Monitoring and evaluation mechanisms are needed to ensure that the change initiative is progressing as planned, the desired results are achieved in a timely and cost-effective way and there is compliance with approved policies and guidelines.

2.67 The Treasury Board Secretariat provided guidelines to departments and a management and accountability framework for departure incentive programs. All departments were expected to be accountable for fulfilling their responsibilities. A series of measures and tools were developed to promote sound management of the programs.

2.68 We examined the extent to which the seven selected departments complied with both the spirit and intent of applicable Treasury Board policies and procedures. We reviewed reports of departmental midterm audits, DND internal audits and Treasury Board-directed audits that covered all departure incentive programs. We reviewed the compliance work of internal audit and, after applying our standards for reliance, came to the conclusion that we could rely on the results.

2.69 A key expectation was that departments would conduct midterm audits of their departure incentive programs. We found that six of the seven departments we reviewed had done so. Statistics Canada did not conduct a midterm audit due to the low number of employee departure incentives granted.

2.70 Our review indicated that the selected departments generally complied with Treasury Board policies and guidelines covering departure incentive programs. However, we noted some deficiencies and areas for improvement, including compliance with rules for executive cash-out programs and controls for monitoring returning employees.

2.71 Since 1992, DND's Internal Audit Division has undertaken comprehensive audits of the Department's human resources management. Among other things, these audits have covered contracting for personnel services, management information systems, military pay and civilian overtime. Internal Audit also conducted a thorough examination of both the military and civilian reduction programs.

2.72 These audits have been crucial to the improvements we observed at DND. Management has recognized the fairness and accuracy of the audits and has responded to the recommendations. Among the appropriate corrective measures undertaken, DND has issued and disseminated a Lessons Learned Report, issued guidelines and monitored post-employment contracts for personnel services, refined eligibility criteria for departure incentives and regularly issued status reports to central agencies and the Department's senior management.

Executive departure programs were generally well managed

2.73 We reviewed the Treasury Board-directed audits of the Executive Employment Transition Policy (EETP) covering five of the selected departments (CIDA, DND, HRDC, Environment, NRCan). Initial concerns about staffing in the Executive category triggered the audits, which examined 74 departure incentives provided to executives between 1 April and 31 December 1995. These audit reports indicated that executive departure programs had been generally well managed. Most paid executive departures had followed the rules; however, the audit reports did note some questionable cases. Six executives received departure incentives after they had been shifted to special assignments, without a corresponding reduction in the established number of executive positions. Three executives received incentive packages while on leave without pay.

Some recipients of departure incentives are returning

2.74 The Treasury Board Secretariat guide on the Public Service Post–Employment Regime, issued on 31 July 1995, outlines the terms, limitations and conditions for those who have received departure incentive packages and later wish to return to the public service as employees or on contract.

2.75 Recipients of departure incentives returning as employees. As indicated in Chapter 1, employees can be rehired or reappointed to positions in the public service, DND and the RCMP. Since July 1995, employees in all organizations returning within the period for which they have received a departure incentive must return, on a pro rata basis, the incentive payment they received. Prior to July 1995, all departments except DND (military) were subject to rules requiring that rehired or reappointed employees repay their departure incentives. Before December 1995, RCMP members were required to repay the remaining value of their incentive payment only if they were re–engaged as a uniformed member. As a general rule, the government does not expect that many former public servants who received departure incentives will return to the public service.

2.76 We noted that between February 1992 and March 1997, about 600 employees who had received a departure incentive were rehired across all departments, DND and the RCMP. The majority (486) were from DND. Of these, 274 were military members who returned to DND as civilians and 73 who returned as military members.

2.77 About 130 of the 600 employees returned within the period covered by the requirement to repay on a pro rata basis the incentive they had received. Most of these rehires (110) were former DND employees. Of these, 75 had returned before Treasury Board established, in July 1995, terms and conditions for the repayment of incentives. National Defence informed us that there was no legal requirement for these employees to repay their incentive payments. This illustrates the importance of having guidelines in place to deal with such situations.

2.78 Of the remainder who returned after 1995, four came back to DND and repaid the appropriate portion of their incentives. In all cases that we examined, the applicable rules were followed. However, we do not know whether the remaining 25 employees rehired in other departments have repaid their incentives as required.

2.79 Recipients of departure incentives returning as contractors. We were also concerned about non–compliance in contracting with recipients of departure incentives. Under the Public Service Post–Employment Regime, former employees are permitted to earn only up to \$5,000 during the “window period” (the number of weeks covered by the cash payment they received) for personal services contracts immediately after employment.

2.80 We could not determine the extent to which recipients of departure incentives were returning on contract during the “window period”. Unless controls were set up to monitor returning employees, this was difficult to track because an individual could return undetected to the same department or another federal department as an associate or employee of a consulting firm.

2.81 National Defence, for example, concerned that military recipients of departure incentives might have returned to the Department on contract, conducted an internal audit. Although there was no specific tracking system for this purpose, an internal audit analysis was performed to identify departure incentive recipients returning as consultants. Over the two–year period under review, 150 recipients were found to have returned as consultants. However, based on a limited review of a sample of these contracting situations, DND Internal Audit indicated that there was no reason to suggest that the rules concerning post employment or conflict of interest had been contravened.

2.82 Weaknesses in the systems and processes for contracting and post–employment were also identified in departments’ midterm internal audit reports. They included a lack of co–ordination between the contracting and human resources divisions and between headquarters and regions to determine whether cashed–out employees were

subsequently rehired under contract (DND military, RCMP); and a lack of regular review and monitoring of contracting with former public servants (DND civilian and RCMP).

Results

2.83 We reviewed departmental results of reduction from four perspectives: expenditure and salary and wage trends during the reduction period; departmental work force reduction and the number of employee departure incentives provided; the cost of departure incentives; and the extent to which departments are meeting their reduction targets.

Most departments reduced their expenditure levels

2.84 Exhibit 2.4 outlines actual expenditure trends from 1993-94 to 1996-97 for the sample departments and the government as a whole. Each departmental chart shows net expenditures (excluding transfer payments and public debt charges) and gross salary and wage expenditure trends.

Exhibit 2.4 not available, see the Report.

Expenditure and Salary & Wage Trends for the Government and Sample Departments (1993-94 to 1996-97)

2.85 Net departmental expenditures have been reduced in three of the departments we examined (Environment, DND and NRCan). In others they have either risen (Statistics Canada) or both risen and decreased (RCMP, CIDA, HRDC).

2.86 In the same period, salary and wage expenditures followed a different pattern. In five departments their level rose initially and then fell. Government of Canada net expenditures and salary and wage trends tended to fall after fiscal 1994-95.

Departmental work forces are being reduced

2.87 We also examined departmental changes in the number of indeterminate employees, from before reductions until 31 March 1997. Exhibit 2.5 outlines the trend in each of the sample departments as well as the number of departure incentive packages provided to employees during the same period.

Exhibit 2.5

Net Changes in Numbers of Indeterminate Employees and Departure Incentive Packages from the Base Year to 31 March 1997

Department ¹	Number of indeterminate employees (base year)	Number of indeterminate employees (31 March 1997)	Decrease (increase) in the number of indeterminate employees	Number of departure incentives provided to employees	Difference between the change in the number of indeterminate employees and the number of departure incentives
DND	117,682	81,023	36,659	22,256	14,403
HRDC	22,639	18,399	4,240	4,439	-199
NRCan	4,599	3,516	1,083	1,076	7

ENV	5,004	4,239	765	811	-46
RCMP	21,122	20,675	447	971	-524
CIDA	1,207	1,208 ⁽²⁾	(1)	83	-84
StatsCan	4,511	4,533	(22)	6	-28

Notes:

¹ Base year: 1991-92 for the Department of National Defence, 1992-93 for the Royal Canadian Mounted Police and 1994-95 for the other departments.

² The number of CIDA indeterminate employees of 31 March 1997 includes 58 indeterminate employees who transferred from the Central and Eastern European Program of the Department of Foreign Affairs and International Trade to CIDA in 1995-96.

Source: Quantitative information concerning indeterminate employees obtained either from respective departments (DND, RCMP, CIDA, StatsCan) or from Treasury Board Secretariat (HRDC, NRCan, ENV). Departure incentive information obtained from departments. With the exception of DND, we did not audit the information provided.

2.88 We found that the number of indeterminate employees in five of the seven departments decreased over the reduction period. Only CIDA and Statistics Canada increased their number of indeterminate employees. In most departments, the number of departure incentives provided to employees exceeded the reduction in the number of indeterminate employees, for such reasons as:

- employees transferred into the department during Program Review (CIDA);
- newly funded initiatives that required additional human resources (Statistics Canada, RCMP);
- the civilianization/reclassification of uniformed positions and replacement of the uniformed incumbents, who departed with an incentive (RCMP); and
- an increase in municipal and provincial contract policing positions by contracting partners (RCMP).

2.89 In DND, however, the reduction in the number of indeterminate employees far exceeded the number of incentive packages provided.

2.90 Exhibit 2.6 summarizes some incremental departure incentive costs to 31 March 1997. The costs of departure incentives varied significantly among the departments selected. The differences can be explained by such factors as the number and type of departure incentives provided by departments, the level of the natural attrition used during reductions, and the profile of departing employees (for example, lower-paid compared with higher-paid employees).

Exhibit 2.6

Incremental Costs of Departure Incentives from the Base Year to 31 March 1997

Department ¹	Cash Incentive Payments ² (\$ millions)	Estimated Pension Waiver Cost for the Early Retirement Incentive Program (\$ millions)	Total Departure Cost (\$ millions)	Number of Departure Incentives
DND	799	78	877	22,256
HRDC	143	247	390	4,439
NRCan	48	49	97	1,076
ENV	35	47	82	811

RCMP	44	3	47	971
CIDA	3	7	10	83
StatsCan	0.2	0.4	0.6	6

Notes

¹ Base year: 1995-96 for all departments except DND (1991-92) and RCMP (1994-95)

² Cash incentive payments consist of those benefits outlined in Chapter 1, Appendix A. Cash incentive payments do not include severance pay paid at the layoff rate.

Source: Quantitative information obtained from the respective departments

Departments are meeting their reduction targets

2.91 The departments we reviewed met their 1995-96 and 1996-97 expenditure reduction targets. We expect that most of them will be able to meet their reduction targets in each of the remaining two years of Program Review if the government continues its commitment to expenditure reduction targets.

2.92 As indicated in Chapter 1, a key reason for this is that expenditure reductions resulting from Program Review are taken out of departmental budgets at the outset of each fiscal year. In addition, we examined the extent to which departments spent within the budgetary levels prescribed by Treasury Board for these years.

2.93 We reviewed the overall funds available for use (spending authority) for each of the seven departments, and their net actual expenditures, for 1995-96 and 1996-97. “Funds available for use” incorporates all changes in funds available to departments, including budget reductions and moneys for new initiatives. We found that from an expenditure reduction perspective, departments spent within their funding limits over this two-year period.

Impacts

2.94 Fundamental change involves risk: risk that the timing will be wrong, risk that what is planned or required will not occur, risk that unwanted consequences will result, or risk that in the long term, the situation will be worse than the current status quo. Program Review and other changes that were occurring across departments presented such risks. As previously noted, planned targets for departmental expenditure reductions — the primary goal of the Program Review exercise — are being met. In addition, Program Review provided a collective opportunity to change the focus of government and the way it functions.

2.95 Our findings were based on departmental studies, departmental midterm audit reports, and interviews with managers, employees and union representatives. Because Program Review and other departmental change initiatives are still under way, any assessment of the impact of work force reduction must be considered preliminary. However, our audit work provides some immediate insights.

Vital operations were maintained in least affected departments

2.96 Of our seven departments, RCMP, CIDA and Statistics Canada were among the least affected organizations. We found that they possessed both the means and the interest to ensure that vital core operations and activities were not impeded by work force reduction requirements.

2.97 As of March 1997, the majority of the RCMP’s work force reductions under Program Review I were in administrative functions. Reductions were also made in airport policing and other peripheral activities, while protecting core policing operations. In addition, the RCMP used other techniques to effect savings in operating expenditures, such as civilianizing positions previously classified as regular uniformed RCMP members. Its

Program Review II reductions are being met by eliminating federal funding for policing at Canada's nine international airports. The RCMP is withdrawing from four airports and recovering its costs at the remaining five. Other reductions will be met through other initiatives, including cost recovery.

2.98 Statistics Canada maintained a no-layoff policy, instead achieving required expenditure reductions by reducing or eliminating specific survey activities and reassigning the employees involved or by redesigning automated survey methods. CIDA made cuts both to its aid disbursements abroad and to its operating and salary and wage budgets, the latter representing the smaller cuts.

2.99 Before Program Review, both CIDA and the RCMP had fundamentally changed the way they were organized and operated. These long-term initiatives remained a departmental priority even as Program Review cuts were announced. In effect, Program Review requirements accelerated the implementation of existing departmental change initiatives.

Some operational impacts were noted

2.100 Staff we interviewed in NRCan, HRDC, Environment Canada and DND identified some significant operational impacts as a result of Program Review reductions. For example, the rate at which Environment Canada's Weather Service accelerated its planned automation and the consolidation of a number of its weather offices reduced its ability to meet certain World Meteorological Organization guidelines.

2.101 Some scientists in NRCan indicated that as a result of reductions, they no longer have the funds and technical staff they need. Others worried that the loss of some key senior scientists may negatively affect their organization's reputation and, as a result, its ability to attract needed funding.

2.102 While HRDC has reported some improvement in its overall level of productivity, there have been some indications of operational problems as a result of work force reduction. The departure of experienced employees and the closing of several offices have, to some extent, affected the level of personalized service to clients. Some managers informed us that office closures have, in some instances, increased clients' waiting time for personalized service.

2.103 National Defence also experienced a change in the Canadian Forces' ability to operate at normal capacity after large reductions in strength and unforeseen peacekeeping demands, which led to some undermanning of key military occupational groups. Internal audit reports indicated that the first two years of reductions in DND caused some shortages in six army combat trades and in vehicle technicians. Similar problems occurred in 1995 with pilots, naval signalmen, naval radio operators and military police. As a result, some additional recruiting was required.

2.104 Expenditure reductions have left many departments with less funds and fewer staff to meet new and changing priorities. The financial flexibility they had in the past to meet these challenges has been greatly diminished. Departments are engaged more than ever in making choices among programs and projects they can no longer fund, practices and processes they can no longer follow, and services they will have to provide either differently or not at all.

2.105 NRCan provides an example of the impact of lost financial flexibility. During 1997, the Department reprofiled its budget allocations to accommodate re-engineering and other initiatives, leading to further downsizing. Unions strongly objected and employee reaction was negative, although departure incentives were still available.

Departments understand their programs and operations better

2.106 Most of the departments we reviewed indicated that Program Review has made it possible for their managers to better understand their programs, operations and activities, how they function and what they contribute. As a result, in many instances these departments have taken the first step toward better handling of the Expenditure Management System, business planning and performance reporting.

Human resource impacts of work force reduction

2.107 We identified some preliminary human resource issues as a result of our audit work in the seven departments and our review of midterm audit reports of 30 other departments. In summary, we found:

- low employee morale;
- lower levels of employee trust in their management and loyalty to their organizations;
- the loss of needed employee skills and experience;
- increased workload per employee; and
- higher levels of employee uncertainty about the future direction of the public service and their departments.

2.108 Some managers and employees in NRCan, Environment Canada and HRDC identified an overall increase in workload per employee. Shortages of skilled and experienced employees were identified in DND, HRDC, Environment Canada and NRCan. Employee uncertainty about their future and that of their organizations has increased in some departments, due in part to shifting reduction targets. While all of these factors impact adversely on employee morale, the effects of continuing circumstances such as fiscal restraint and salary freezes before and during this period cannot be discounted.

2.109 However, we also received positive comments on the human resource impact of work force reduction. Employees and union representatives in some departments praised management's handling of reductions. Very few grievances were filed in the seven organizations. Managers also noted that work force reduction and financial incentives have created an opportunity to renew and restructure the work force by releasing employees considered unsuitable for future responsibilities in the changed departmental structure.

Work force age distribution has changed in departments

2.110 We examined the age distribution of the seven departments both before work force reduction and as of 31 March 1997. We found that departmental work forces have generally become more middle-aged. In 1997 there were proportionally fewer employees below age 40 than five years ago. For example, DND's under-40 civilian work force has decreased since 1992 by about seven percent, while the number of employees between 40 and 50 has increased by 15 percent. This change is consistent with the fact that about one in three departures was by an employee either younger than 40 years or 60 and older.

Some departmental occupational groups have been significantly reduced

2.111 Our review of selected departments reveals that some occupational groups have been significantly affected by work force reductions from March 1995 to March 1997.

- The Administrative Services Group was reduced by 22 and 19 percent in HRDC and NRCan respectively.
- The Clerical and Regulatory Group decreased by 31 and 22 percent in NRCan and HRDC.
- The Secretarial Group was reduced by 44, 40, 29 and 21 percent respectively in HRDC, NRCan, RCMP (public servants) and Environment.
- DND civilian administrative support and operational groups were reduced by about 30 percent.

2.112 We also noted that the Executive group at NRCan has been reduced by 29 percent since 1995. Since 1992, the upper rank levels in DND (lieutenant colonel and above) have decreased by 24 percent. Our review of Treasury Board Secretariat data concerning Natural Resources Canada and Environment Canada, two major science-based departments, reveals that since 1994 the number of indeterminate employees in their science and technology groups has been reduced by about 23 percent. The total impact will not be known until the end of Program Review in 1998-99.

Conclusion

Lessons Learned and Recommendations

Reduction initiatives need effective management

2.113 Our review of departmental leadership as well as planning and implementation practices confirmed that expenditure and work force reductions require effective management. We found leadership and strong senior management involvement in the seven departments selected. Any change process of the magnitude of Program Review requires continuing political commitment and leadership at the top to ensure that goals are met and direction is maintained.

Readiness for change is an advantage

2.114 The management of change is now, more than ever, an integral part of ensuring survival in both the public and private sectors. The operating cultures of many organizations are shifting to embrace change as a prerequisite to continued organizational viability. Departments that we examined are also undergoing this change in management culture and recognizing the need for ongoing mechanisms to deal with it.

2.115 Strategic planning was an important mechanism for managing departmental reduction effectively. Departments that had already been rethinking their operations and organizational structures were better able to make effective use of the limited time available to plan for expenditure reductions. They were also able to integrate their reduction initiatives with their re-engineering efforts.

2.116 Some of our sample departments were already engaged in advanced planning and preparation at the outset of Program Review. Statistics Canada provided a good illustration of ongoing structural readiness for change as it had altered its planning, operating and monitoring infrastructure in order to cope with the degree of continuing change it anticipated.

2.117 In our view, Program Review gave most departments enough time (three years) to carry out each phase of required reductions, a feature that increased departmental planning options and allowed for a longer-term approach and a more orderly transition process.

More emphasis on costs is needed

2.118 Departmental priorities have clearly been focussed on meeting reduction targets in a humane and timely manner, while placing less emphasis on cost management. The lack of emphasis on cost management, coupled with the number and value of departure incentives offered to employees, contributed to higher than expected costs of reduction in some departments.

2.119 In our view, the Treasury Board Secretariat could have done more to ensure that departments were fully accountable for their use of costly employee departure incentive packages. While the concept of “payback” was sound, there were several concerns about the way it was designed, applied and calculated at the departmental level. We have found some improvement since our 1992 audit, but departments continue to put limited emphasis on the costs associated with reducing their work forces.

2.120 In future, Treasury Board Secretariat needs to work more closely with departments to ensure that they strike an appropriate balance between meeting reduction targets in a humane and timely manner and managing the costs of reduction programs.

2.121 **At the end of Program Review, Treasury Board Secretariat should work with departments to determine final work force reduction costs and final reductions in salary and wage expenditures. Treasury Board Secretariat should ensure that Parliament is fully informed.**

Treasury Board Secretariat’s response: Departments are reporting work force reduction costs and expenditure reductions to us on an ongoing basis. We accept that we will report, comprehensively, at the end of Program Review, scheduled for March 1999.

2.122 Good management relies on timely, accurate information. Reduction initiatives are not alone in their need to be supported by information. Any complex decision-making process must have access to sound data. We found that departments had some initial problems identifying and providing the necessary financial and human resource information. Departments that were already changing or reducing their organizations when Program Review began had ready access to relevant management information that supported them in handling requirements for reduction. Others had to build this capability over time.

2.123 **As an important first step in any future change initiative of this magnitude, departments should ensure that they have the necessary financial and human resource information available on an ongoing basis.**

Treasury Board Secretariat’s response: The Treasury Board Secretariat will continue to ensure that financial and human resource information systems are adequate to meet management and reporting requirements. In co-operation with departments, we will make required improvements and departments will be given greater access to integrated data bases developed at the Treasury Board Secretariat.

Need for a sustainable and adaptable work force to meet future challenges

2.124 In light of ongoing reduction activities as well as other departmental changes, it is essential that departments continue their efforts to identify and assess the impact of recent reductions on the composition and capability of their work forces. The loss of both younger and older employees presents specific challenges for the future. Some key aspects to examine would include the change in overall levels of employee experience and

competency, vulnerability to future losses arising from attrition and retirement, and the need for different and accelerated recruitment strategies.

2.125 In 1997, the Privy Council Office launched a public–service–wide program called La Relève. Its purpose is not only to address long–standing human resource issues but also to deal with the consequences of work force reductions under Program Review. Its ultimate goal is to revitalize the federal public service as an institution.

2.126 **Departments should continue to examine the impact of expenditure reductions on the composition and competency profile of their current work forces and prepare plans to meet identified future challenges.**

Treasury Board Secretariat's response: La Relève has brought an enhanced awareness to the Human Resource Planning imperative and the need to support employees so they will continue to provide high–quality services to the Canadian taxpayers.

Need for priority in dealing with human resource impacts of reduction

2.127 Generally, the departments we examined were good examples of fair and sensitive treatment of departing employees. However, the remaining work force may be vulnerable. In her Fourth Annual Report to the Prime Minister on the Public Service of Canada (1997), the Clerk of the Privy Council speaks of a “quiet crisis under way in the public service today”, fueled in part by the results of the recent work force reductions. Our audit findings on human resource impacts, particularly in the most affected departments, support that concern.

2.128 Management and employee concerns about the loss of experience and qualified employees, the perceived high level of workload per employee and uncertainty about future departmental direction best characterize the current mood in these departments.

2.129 Management now needs to focus on the employees remaining after the reductions have taken place. In general, this will require focussing on the remaining departmental work force from the perspective of changes in work processes, employee retraining and future workload and productivity requirements.

About the Audit

Objectives

- To determine the extent to which announced targets for expenditure reduction or, where specified, work force reduction have been or are likely to be achieved.
- To identify the cost of work force reductions and to determine the extent to which the initiatives resulted in savings.
- To assess the extent to which departure incentive programs were managed in accordance with relevant policies, directives or guidelines.
- To identify lessons learned for possible application in the future.

Scope

We examined expenditure and work force reduction efforts at both the central agency and departmental levels from the perspective of leadership, accountability, planning, implementation, cost, results and the impacts on departments and employees.

We reviewed the evolution of expenditure and work force reductions over the years, with an emphasis on the management and results of expenditure and work force reductions announced since 1995, in the context of Program Review. Our audit covered the departure incentive programs described in summary in Chapter 1, Appendix A, including the Work Force Adjustment Directive (WFAD), Force Reduction Programs (FRP), the Civilian Reduction Program (CRP), the Early Retirement Incentive (ERI), the Early Departure Incentive (EDI), the RCMP Work Force Adjustment and the Executive Employment Transition Policy (EETP). We also considered the results of work force reductions due to privatization and devolution.

In Chapter 1, we report on activities of central agencies, including the Department of Finance, the Treasury Board Secretariat, and the Privy Council Office in relation to expenditure and work force reductions. We examine issues such as central planning, direction and guidance, the management and accountability framework, and the achievement of overall results. The rationales for the expenditure reduction decisions themselves were excluded from the scope of our audit, as was the evaluation of the effects of work force reductions on individuals who had already left.

In Chapter 2, we review the implementation and management of expenditure and work force reductions in seven departments selected for detailed audit work. The departments were the Canadian International Development Agency, Environment Canada, Human Resources Development Canada, National Defence (military and civilian), Natural Resources Canada, the Royal Canadian Mounted Police (members and civilians), and Statistics Canada.

Criteria

The criteria used in this audit were drawn from Treasury Board Secretariat policies, directives and guidelines as well as best practices from public and private sector experience with expenditure and work force reductions.

We expected:

- goals, objectives and parameters of expenditure/work force reduction initiatives to be clear and consistent with government intent;
- appropriate rationales to be prepared in support of reduction decisions;
- roles, responsibilities and accountabilities to be clearly identified and communicated;
- central agency officials and senior departmental officials to clarify in a timely manner reduction initiative expectations and procedures;
- plans to be in place to ensure effective implementation of reductions at both the departmental and service-wide levels;
- appropriate mechanisms to be in place to monitor progress, and adjustments to be made where required;
- reductions to be made in accordance with the spirit and intent of relevant central agency and departmental policies and directives, including guidelines on ethics and conflict of interest;
- results to be periodically evaluated and reviewed, and corrective action taken where indicated;
- expenditure reductions, work force reductions and savings to be consistent with approved target expectations;
- impact of reductions to be identified; and
- results, including work force reductions, costs, savings and effects, to be reported to appropriate authorities.

Approach

We focussed our examination primarily on actual government and departmental expenditure and work force reductions covering the period from April 1995 to March 1997 and, to some extent, those estimated up to March 1998. In the case of the Department of National Defence, our audit work included the period from 1991 to 1997, to cover both the Force Reduction and the Civilian Reduction programs. Our audit of RCMP covered the period from April 1994 to March 1997. Where appropriate and to the extent possible, we have relied upon audit work conducted on behalf of central agencies and in departments that we examined.

We gained an understanding of the evolution and history of expenditure/work force reduction since its inception in the 1960s. We reviewed the best practices related to reduction initiatives in both the public and the private sectors in Canada, as well as in the United States, Australia and New Zealand.

Our audit work included interviews, reviews of documentation, and analysis of information contained in numerous information systems managed by the Treasury Board Secretariat, the Department of National Defence or Public Works and Government Services Canada. Where appropriate, we have also drawn from relevant audits or follow-up work performed by this Office.

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Chapter 3

National Defence —

Equipping and Modernizing the Canadian Forces

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National Defence —

Equipping and Modernizing the Canadian Forces

Main Points

3.1 A modern, multi-purpose, combat-capable force able to “fight alongside the best, against the best” is necessary to fulfil Canada’s defence policy commitments, although the policy does not require the Canadian Forces to possess every component of military capability.

3.2 According to Department of National Defence officials, Canada’s White Paper commitments are defined by the defence capabilities of the Canadian Forces. We found many equipment deficiencies that limit capabilities.

3.3 If the status quo persists, the Department’s available capital funding may not be sufficient to equip and modernize the force that National Defence is currently planning. Officials told us that they expect to be able to increase the capital portion of the budget. Nevertheless, they anticipate that hard choices may have to be made.

3.4 Personnel, operations and maintenance costs are rising, which is further reducing the portion of the budget available for capital equipment.

3.5 We found that the Department does not have an adequate policy framework to direct the almost \$1.4 billion it spends each year on equipment modernization. It does not yet have in place fully developed operational scenarios to guide planners, or performance information that identifies gaps.

3.6 Some other countries — notably the United States and New Zealand — have taken the lead in the way their government budgeting and management systems actively manage defence policy and resources.

Introduction

A Multi-Purpose Force Is Required

3.7 In 1994, the federal government released its Defence White Paper to “guide the work of the Department and the Forces into the next century.” According to the White Paper, the Canadian Forces are to be multi-purpose and combat-capable, able to fight alongside the best, against the best. It recognizes that Canada cannot cover the entire military spectrum, but the Canadian Forces must be capable of defending Canada as well as defending North America in co-operation with the U.S. military, on land, at sea and in the air. They must also be able to contribute to international peace and security.

3.8 The army is to consist of three brigade groups, adequately equipped to carry out their tasks. The navy must provide two naval task groups for a fleet balanced between Canada’s two open-water oceans. The air force must maintain capabilities for domestic and international operations, including fighter and transport aircraft, search and rescue, and maritime and tactical air support.

3.9 The 1994 defence policy announced cuts in most areas of defence. In response, the Department cut planned spending on equipment by \$15 billion over 15 years. Some equipment projects were eliminated, reduced or delayed. The government wants National Defence to extend the life of its equipment, where cost-effective and prudent, and to buy new equipment only if it is essential to maintaining core capabilities. Resources are to be transferred “to where they are most needed — mainly to land combat and combat support forces.”

3.10 In 1994, the Special Joint Committee of the Senate and the House of Commons on Canada’s Defence Policy recognized that “less money means less equipment or less capable equipment”. It warned, “Budget cuts mean that the Canadian Forces may not have the capability to undertake tasks which the government would like them to take on.”

3.11 The Committee concluded that the Canadian Forces could not make do with less. It said, “Our present [1994] military forces are barely adequate.” In the Committee’s opinion, National Defence required a “significant refocussing of mission and reallocation of resources to do the job we are asking them to do today.”

3.12 The Committee called upon Parliament to play an increased role in defence issues. It saw the need for regular review of defence policy and budgetary and procurement issues, involving both the Senate and the House of Commons.

Funds for Equipment Modernization Are Declining

3.13 Re-equipping the Canadian Forces has been a priority in defence policy since the 1970s, but recent defence budget reductions have slowed the pace of equipment modernization. The defence policy of 1987 recognized that years of declining spending on new equipment were causing a significant gap in the military’s ability to meet its commitments. To fix this problem, the government announced in its policy that it would alter some commitments and begin a long period of “steady, predictable and honest funding”.

3.14 In the late 1980s, spending on equipment, adjusted for accounting changes to Research and Development and Ammunition, accounted for about 20 percent of the defence budget. The government saw that “even this funding is insufficient to overcome the bow wave built up since the 1960s.” Nevertheless, spending for equipment

modernization has fallen to about 14 percent of the defence budget today (1998-99), which is lower than the historical targets set to ensure that modernization continues for the Canadian Forces.

3.15 In 1996, following a series of budget reductions, the Department made a commitment to avoid repeating the experience of the early 1970s when “rust-out” became a serious problem. Rust-out refers to deterioration in the condition of equipment that develops as old or obsolete equipment is not replaced. Although the Department did not expect reductions to affect the Canadian Forces’ ability to fulfil its tasks and missions, it recognized that a higher level of spending on equipment would be needed over the longer term. Despite this commitment, Long-Term Capital Plans and the Defence Services Program currently forecast a decline in equipment spending over the next five to 15 years.

Concerns Raised in Our Previous Audits

3.16 Since 1984, we have been reporting our concerns about spending for equipment modernization. We have commented on the Department’s inability to set priorities, develop adequate cost information or ensure that equipment plans were affordable.

3.17 In 1984, we found weaknesses in the Department’s process for linking policy to the equipment needed to fulfil the policy.

3.18 In 1992, we noted that the Department lacked a system for setting priorities in the Defence Services Program. The Department told us then that by mid-1993, reforms to the Defence Program Management System would provide the basis for full documentation of priority setting.

3.19 In 1994, we reported that the policy planning and force development process needed improvements to resolve gaps and make plans affordable. The Department did not have conflict scenarios to provide guidance to force development planners. The Department agreed to provide greater detail in its policy documents about the kinds of situations the Canadian Forces would face; it said affordability would continue to be a major priority. Program or policy changes would be made if appropriate.

3.20 Most recently, in 1996 we found that some equipment for the army, particularly for peacekeeping, was deficient for the missions and tasks being undertaken.

Focus of the Audit

3.21 The present audit was intended to determine how well the capital equipment program of about \$1.4 billion each year is doing at maintaining the modern, multi-purpose forces required by the government’s policy. It was conducted in concert with the audit reported in Chapter 4, which examined how well the Department manages its projects to buy major capital equipment.

3.22 Further information on our objectives, scope and criteria can be found at the end of the chapter in the section **About the Audit**.

Observations

The Canadian Forces Are Trying to Cope with Equipment Deficiencies and Shortages

3.23 The Canadian Forces must maintain their core capabilities in order to be able to meet their commitments. The army, navy and air force each have roles that are essential to the success of the Canadian Forces in defending Canada and North America and contributing to international security. However, equipment deficiencies and shortages limit the capabilities available to implement the 1994 Defence White Paper. According to Department officials, the capabilities that are maintained define what Canada will accept as defence commitments.

3.24 In December 1997, the Deputy Chief of the Defence Staff asked the army, navy and air force to review their present ability to deploy Main Contingency Forces as called upon in the defence policy. This staff analysis is to be based on current capabilities and is to be completed by April 1998. While the review is intended to define the current state of the Canadian Forces, it does not attempt to forecast their future effectiveness. In addition to this review, Mobilization Plans are being developed as directed by the defence policy and are also expected to be completed by April 1998. Finally, the Department informed us that it is also reviewing its Defence Planning Guidance document to address affordability and future force structure issues.

3.25 We examined the current deficiencies in equipment capability that the Canadian Forces have identified, and their assessments of how these deficiencies affect operations. We then reviewed equipment modernization plans and the time frames for correcting the deficiencies.

Naval task groups need better support

3.26 Defence policy requires the navy to have a balanced fleet able to deploy on both coasts. A balanced fleet means the navy can operate effectively on, above and under the ocean surface. We examined the navy's own assessments of its fleet and maritime air assets on the east and west coasts as well as for Canada's international obligations.

3.27 At the time of our audit, the navy stated that although it is well served by its surface fleet of modern warships, concerns remain about its helicopters and replenishment ships, which provide support, and its submarines. There are gaps in strategic surveillance and only a very limited capability to exert national will in the very demanding environment of Canada's Arctic.

3.28 The Department reported in 1997 that "critical deficiencies exist in the maritime helicopter and submarine fleets." The navy relies on the air force to provide air support for its naval task groups and to conduct maritime surveillance. In order to be effective at sea, the naval task groups require shipborne helicopters to operate with destroyers, patrol frigates and support ships. The Department has planned a project to address maritime helicopter deficiencies, but they will continue until new helicopters are delivered.

3.29 Lack of submarines has meant that the navy's ability to meet its obligations on the west coast has been limited since 1974 and it does not expect to have current deficiencies resolved until sometime after 2005. The navy has three submarines to protect Canada's coastline but in Maritime Command's Naval Vision, the Chief of Maritime Staff calls for up to six submarines to properly meet defence policy requirements. The existing vessels are over 30 years old and are becoming obsolete. Submarines are currently a defence priority.

3.30 According to the Naval Vision, the naval task groups call for four support ships for the east and west coasts to support operations and provide adequate strategic sealift capability. The navy is currently operating with only three support ships, and the planned retirement of *HMCS Provider* in 2001 will add to existing limitations. A project to replace the support ships has been put forward for future consideration.

The army has difficulty keeping pace with technology

3.31 The government expects the army “to fight in joint, combined and coalition operations in all types of environments.” It must be able to respond with existing resources to operations other than war and must also be prepared to mobilize should Canada have to fight a major war.

3.32 In the 1994 Land Force Development Guide, the army stated that operationally it had not kept pace with technology to modernize its equipment, leaving it vulnerable to threats in low-level and mid-level operations. Its infantry and armour could be detected, engaged and defeated long before it was known that an enemy was present. Canadian artillery could not fire effectively because of limitations on its ability to locate and identify targets. The army was struggling to acquire the 1970s and 1980s technology to fight air/land battles even though the next-generation “information battlefield” had already arrived. Our review of departmental documents confirms that many of the 1994 Land Force concerns are still concerns today.

3.33 The army is introducing new technology as funding permits, but acknowledges the difficulty with the current pace of technological change. Since 1994, the army has initiated several projects to upgrade its equipment. For example, reconnaissance vehicle deficiencies are to be addressed by 1998-99; the Leopard main battle tank is being fitted with a thermal sight ; and the army has received government approval to replace 240 of its armoured personnel carriers. It is also working on implementing a Land Force Command communications system by 2001, which, the army has informed us, will be fully interoperable with other Canadian Forces command and control systems.

3.34 But the army continues to face other ongoing deficiencies. Its armour combat vehicle has been considered unsuitable as an operational vehicle since 1981, and is particularly inadequate for peacekeeping. Although the thermal sight on the Leopard tank is being added, other upgrades to improve its firepower and armour have been delayed. The army is planning to replace only about one third of its armoured personnel carriers and to upgrade the remainder. Departmental documents dated from 1994 to 1996 state that these vehicles could put troops at unacceptable risk when used on assigned missions. However, officials told us that the army’s equipment rationalization program should go a long way to reducing the risk that troops could be exposed. Once implementation is complete, front line troops will be equipped with the most up-to-date light armoured vehicles while other troops will have upgraded armoured personnel carriers.

3.35 The army relies on the air force for tactical transport. The Griffon utility helicopter recently acquired for the air force is able to provide troop transport and conduct limited reconnaissance operations. It is capable of lifting the army’s lightweight artillery only very short distances. With its Griffon helicopters, the air force cannot provide direct fire support for the land troops. However, trained aircrew can communicate with ground forces and co-ordinate fire support by using binoculars and following artillery procedures.

The air force is facing obsolescence

3.36 The air force faces “a serious risk of obsolescence and capability degradation in a number of key areas”, as it reported in the National Defence 1997-98 Estimates. Defence policy calls on the air force for seven key capabilities — fighter capability, strategic transport and air-to-air refuelling, tactical transport and air-to-air refuelling, support to the navy, support to the army, search and rescue and Arctic surveillance.

3.37 The air force currently believes it is not fully capable in all its core areas, but in some of its key capabilities it is better able to meet commitments than in others. For example, the strategic and tactical transport aircraft are able to provide airlift for passengers and cargo, and its tactical transport aircraft can do some air-to-air refuelling. The tactical transport aircraft need avionics updates to ensure that they remain effective until 2010, when they may be retired. A project is under way to have aircraft upgrades completed by 2000.

3.38 However, deficiencies in helicopters and other capabilities are of immediate concern and place real limitations on the ability of the air force to provide support to the navy and army. The air force has identified five areas in which capability deficiencies need to be fixed to maintain the minimum standard needed for interoperability with allies and for Canada's fundamental security needs — search and rescue helicopters, shipborne maritime helicopters, life extension of the Aurora patrol aircraft, systems life extension for the CF-18 fighter aircraft and region/sector operations control centres.

3.39 Buying new search and rescue helicopters has been a departmental project for over 10 years. The deficiencies of the current Labrador helicopters have recently been addressed by the government and new helicopters for search and rescue could be in use by 2003.

3.40 The Aurora maritime patrol aircraft was acquired in the early 1980s and now needs upgrades to address and update its limited maritime surveillance capability.

3.41 The CF-18 fighter aircraft is required for the defence of Canada and to meet international commitments to NATO and NORAD. It was acquired in the early 1980s and now lags behind advanced technology available in other aircraft that represent a potential threat. While the CF-18 now has precision-guided munitions and associated delivery systems, other components are reaching the limits of their capability. System upgrades to the CF-18 fighter aircraft are a priority for the Department. However, plans to implement them have been deferred.

Money for Capital Spending Is Shrinking

The Department cannot afford all the equipment forecast to fully modernize the Forces

3.42 The National Defence budget is divided into expenditures for personnel, operations and maintenance, some statutory payments as well as grants and contributions, and capital. Capital funding includes money to modernize equipment for the Canadian Forces.

3.43 In 1987, the government became concerned that the gap between defence capabilities and policy commitments had become too great. It stated its intent to re-equip the military and prevent impending rust-out.

3.44 Despite recognition of the problems facing National Defence, like other departments it has had to cope with shrinking budgets. In 1988-89, at the end of the Cold War, the Department was spending about \$11.4 billion — about \$14 billion in current dollars. This year, it will spend about \$9.7 billion (1998-99), 30 percent less in real terms than a decade ago.

3.45 The internal demand for funds for personnel, operations and maintenance is growing. Each year as operating costs increase, less and less funding is available for capital expenditures. In 1988-89, National Defence spent \$2.2 billion on capital equipment, or about 20 percent of its budget, which in current dollars is about \$2.8 billion. Today its capital equipment spending has dropped by 50 percent in real terms to about \$1.4 billion (1998-99), or 14 percent of the defence budget.

3.46 In 1996, the Department stated that it was “committed to avoid repeating the experience of the early 1970s when funding restrictions led to a rust out of major equipment. Over the longer term, the Department will have to address the need to return to a higher level of capital spending in order to prevent rust out.”

3.47 We examined forecast capital funding over the long term and found that unless significant adjustments are made, it could decline to a very low level. Although the National Defence budget is expected to increase to compensate partially for inflation, within the next 15 years — if current trends continue — spending on capital could approximate 1970s levels (Exhibit 3.1). Our analysis found that in the worst case, capital expenditures could drop as low as 9 to 12 percent of the defence budget by 2012-13.

Exhibit 3.1 is not available, see the Report

Forecast Trend in Capital Spending

3.48 The Department recognizes that equipment modernization would be unsustainable at a spending level of only 9 to 12 percent and explained that it would take and is taking action to prevent this situation from occurring. Nevertheless, departmental officials told us that hard choices may have to be made involving several options that could be pursued, other than maintaining the status quo. Overall, the options are:

- to continue the status quo, annually reviewing the cost of projects so that long-term capital plans are kept within capital funding limits;
- to seek increased funding from government, some of which could be directed to capital, pursue additional internal efficiencies and reallocate some savings to capital; and
- to strategically rethink, over the long term, the structure and operations of the Canadian Forces.

Option 1: The status quo

3.49 The Department has identified capital projects to correct deficiencies in its equipment. Projects in the army, navy and air force as well as information technology business plans represent an estimated demand of almost \$11 billion on the capital budget over the next five years. However, the status quo would see only \$6.5 billion available for equipment spending. To meet all the requirements for these equipment projects, the Department would need to almost double the amount of funding it has allocated from its budget for equipment modernization.

3.50 The Department develops a Long-Term Capital Plan for equipment to identify which projects it can afford to undertake with the available funding, when it can start funding these projects and how much it can allocate to each of them.

3.51 The Department cannot undertake all the projects it has identified in its business plans; it will have to reduce, eliminate or defer some projects or project phases to later years until funding becomes available. Over time, as more and more projects are delayed, the Department will experience a growing amount of deferred expenditures needed to fix capability deficiencies.

3.52 Defence is deferring more and more equipment projects. Growth in the number of deferred equipment projects is an indicator of whether the Canadian Forces can keep pace with demands to modernize aging equipment and avoid rust-out. The government referred to this backlog of demands in 1987, indicating then that it had become a serious problem.

3.53 With the status quo, the amount required to fund deferred equipment projects could reach as high as \$5 billion over the next five years and we estimate between \$20 billion to \$30 billion by 2012-13. This is based on all

the potential projects identified by the Department. Some of these projects could be reduced or eliminated as the Department reassesses its needs or finds less expensive ways to modernize equipment. At this point, however, the Department has not been able to say which projects could be redundant, or less expensive than now anticipated. As well, new projects could be added as other equipment modernization needs become apparent. As a case in point, we identified in current business planning documents almost \$300 million in potential new demands.

Option 2: Identifying more funding for equipment modernization

3.54 In the near term, the Department is seeking to increase its reference levels and compensate for rising personnel costs funded by reducing capital. These adjustments could add almost \$700 million to capital equipment funding over the next five years.

3.55 As part of its renewal efforts, the Department is adopting innovative business practices and identifying Alternative Service Delivery options that may result in significant savings. It is also targeting improvements in productivity to achieve savings in operations. For example, departmental officials told us they are considering reducing the frequency of personnel transfers; they estimate that this could save up to 50 percent of current moving costs, or about \$100 million per year.

3.56 This increased funding for equipment could, at the end of five years, reduce the amount of deferred equipment spending to less than \$4 billion. In addition, in the Department's opinion, current project cost estimates can and will be reduced, which could provide a less costly picture of deferred demand. However, as we note in the next section, some costs appear to be increasing.

Option 3: Long-term strategic rethinking of the Canadian Forces

3.57 Should funding prove inadequate to sustain the current force structure, re-examination would be required. The Department has already initiated a long-term examination of the Canadian Forces. Its plans include examining capabilities, future force size, force development priorities and new ways to support operations. The objective is to ensure that the Canadian Forces of the future can provide adequate defence capability.

3.58 This strategic rethinking of the military may require significant changes to the Canadian Forces in order to operate within funding limits. Department officials stated that it may be necessary to reduce the number of military and civilian personnel. Changes may be made to the force structure that would require less or different equipment than is currently needed. Readiness may be reduced to levels that would require longer notice than the current 90 days to be able to deploy, and might require a strategic warning period of several years. These options will be examined in context with the role the government expects the Canadian Forces to fulfil and the funding provided to maintain capabilities.

3.59 Overall, officials told us that the first option — maintaining the status quo — is the least likely to be selected.

Rising Costs of Operating Equipment Put Capital Funds at Risk

3.60 The decline in capital funding is partly due to growing pressure on the National Defence budget from the rising costs of operations and maintenance (O&M). As equipment ages, it reaches a point where labour and spares required for both upkeep and repairs make it increasingly expensive to maintain and it spends more time out of service. New, more technical equipment, while providing improved capability, can cost more than the old to operate and maintain. Keeping O&M costs within budget is an ongoing challenge.

3.61 In its 1996-97 Business Plan, the Department reported that it had introduced “changes to infrastructure, support concepts, operating tempo, equipment fleet mixes, as well as many re-engineering and information technology initiatives which will permit net operations and maintenance costs to be constrained to approximately 30 percent of available funding.” Despite this effort, our analysis of expenditure plans shows that spending on O&M will exceed the 30 percent target by next year (1999-2000).

3.62 The Department has considered reducing operations as one way of containing O&M costs but has concluded that little or no savings would result. A recent study by the US Congressional Budget Office also found that there was only a limited relationship between trends in O&M spending and operating activity. Similarly, we agree that National Defence is unlikely to contain O&M costs by reducing its activity levels. We found that such a large portion of O&M expenditures are fixed costs that it would be difficult to create short-term savings. About 15 percent of total O&M costs vary with equipment usage and the remaining 85 percent are either fixed equipment costs or are not related to equipment (Exhibit 3.2). Therefore, reducing equipment use would create only a small amount of savings in O&M overall. For example, we estimate that a 10 percent reduction in air force flying hours would reduce aircraft O&M costs by only 3 percent. A 10 percent reduction in navy time at sea would reduce ships O&M costs by only 2 percent. Finally, a 10 percent reduction in the use of army vehicles would reduce their O&M costs by only 4 percent.

Exhibit 3.2 is not available, see the Report

Most Equipment Operations and Maintenance Costs Are Fixed

3.63 The Department identified several other actions it has taken to contain O&M by reducing non-equipment O&M spending like infrastructure and dependency support. However, the expected savings have yet to be fully realized. For example, O&M funds for the maintenance of vacant infrastructure and for dependency support are still being spent at army bases closed during the Infrastructure Adjustment Program, and overall army infrastructure has increased. The army noted in its Report on the Fundamental Review of Operating Budgets, “Infrastructure increases [are] cause for serious concern over the long term as available O&M funds are spread ever more thinly and as rust-out starts to impose its inevitable grip.”

3.64 In the past the Department has reduced O&M allocations across the board rather than targeting specific areas. There is a risk that such reductions will not actually be realized. The army has already experienced difficulty keeping expenditures within targets. It estimates that the gap between its O&M needs and budgeted funding will grow to almost \$140 million by next year (1999-2000).

3.65 Other commands have also forecast shortages in O&M funding. The air force is at a critical point: current funding is barely adequate. In its planning documents it states, “Because force structure and cost analysis planning tools are still under development, it remains to be seen whether CC3 [the air force] will be able to effectively meet the tasks and commitments called for by the Defence Planning Guidance 97 with the operations and maintenance resources provided.” The navy has stated in its 1997-98 plans that the operations it can perform within the O&M funding available represent a very lean program for the navy and, although the navy will meet its assigned missions, this will not be to the standard preferred.

3.66 O&M is managed within the budgeted funding, but estimated needs often exceed the funds available. The Materiel Group has estimated the gap between the Department’s O&M needs and its budgeted funding. The gap is currently forecast at \$240 million during the first year of the current five-year planning period (1998-99) and \$334 million the following year. We estimate that if the identified gaps could be addressed, O&M would approach 35 percent of departmental expenditures.

Buying new equipment puts more pressure on the budget

3.67 In order to maintain O&M costs at current levels, the Department is calling for the O&M saved on equipment being replaced to fund the O&M costs of the new equipment. However, new equipment may be more costly to operate and maintain than the old.

3.68 Indeed, new equipment could cost the Canadian Forces two to three times more to operate and maintain than the equipment it is now using. For example, the army's new reconnaissance vehicle, the Coyote, is expected to cost \$15.4 million per year to operate and maintain — 275 percent more than the vehicle being retired. Operating and maintaining the new Griffon helicopter may cost the air force 20 to 40 percent more than the three helicopter fleets it is replacing, based on the data available at this time.

3.69 As new equipment is purchased, or more sophisticated equipment acquired, O&M costs are likely to increase. And as O&M becomes a larger share of the defence budget, less funding is left for capital purchases needed to replace other aging equipment. An analysis conducted by Dr. John Treddenick at the Royal Military College found that under current plans, the Department will experience increasing O&M and personnel costs, which demand greater shares of its budget. His analysis warns that within the next 15 years, little funding may be left for capital acquisitions (Exhibit 3.3). Under these circumstances, the Department is facing increasing rust-out as its ability to purchase new equipment declines.

Exhibit 3.3 is not available, see the Report

Forecast Capital Spending Trends in Relation to Other Spending

Forecasts show capital expenditures are a decreasing portion of the defence budget as O&M and personnel expenditures increase.

Equipment Modernization Needs Better Guidance

3.70 Weapon systems have a very long service life — often 30 years if upgraded throughout their life cycle — and can cost billions of dollars. Decisions on how a force is to be equipped are therefore very important and need to be part of a long-range strategic plan. We examined the Department's plans to determine if policy and doctrine were specific enough to guide major acquisitions; if there were operational scenarios in place to describe what equipment was supposed to be able to do; if performance information was sufficient to alert officials to areas where capabilities were declining and required renewal; and if there were clear priorities to guide investment.

Performance information is not yet available

3.71 The Department of National Defence has had some success in developing its performance measurement framework but less success in producing targets and measuring outcomes. The 1997 Performance Report provided information on expenditures that was much like the Part III Estimates, rather than reporting on how well key results expectations were met.

3.72 The Department has not yet fully developed performance measures that would enable decision makers to judge how well the Canadian Forces are operating and where to focus efforts. As one command has reported, "The absence of a credible performance measurement system remains a major impediment to the capability planning process."

3.73 The new departmental fall Performance Report and the Spring Report on Plans and Priorities replace Part III of the Estimates and are intended to provide Parliament with improved performance information. However, the Department does not have a financial system that allows it to report on its business lines — Defence of Canada, Defence of North America and Contribution to International Security. Financial and performance information,

providing measurable performance expectations with a focus on outcomes, will not be available for two more years. Distinct from what our audit found, the 1997 Performance Report has not reported to Parliament that “hard choices” may have to be made.

Priorities are not clear

3.74 In order to focus on their most pressing needs, the commands and the Department have stated their priorities for capital equipment acquisition. Each year the army, navy and air force plan how they will spend the resources allocated to them. However, as noted by one of the commands in its plans, “Without both a defence task priority model and activity based costing of all processes and sub-processes, we will continue to allocate departmental resources to capability components more on ‘gut feel’ than ‘good management.’”

3.75 Annually, the Department issues its Defence Planning Guidance to all commands to provide strategic guidance. Using this guidance, the commands develop their business plans for the following year, and determine their equipment needs. In their plans they define their command equipment priorities.

3.76 Setting overall departmental priorities is the responsibility of the Defence Management Committee. We found no evidence to indicate what criteria the Department uses, other than statements in the White Paper that the Department is to emphasize equipment life extension and maintenance of “core capabilities”. According to the Vice Chief of the Defence Staff, the process is adversarial and concludes with senior direction that balances requirements and affordability.

Scenarios to guide planners are not fully developed

3.77 In 1994 we commented that scenarios were necessary to describe the circumstances in which the Canadian Forces might be employed. These scenarios then would allow planners to select equipment. At that time the Department agreed with our assessment and, in 1996, stated that it was developing scenarios. Its Defence Planning Guidance 98 notes that while scenarios are still in the development stage, the Department remains committed to meeting the requirement and included the descriptions of 11 scenarios that are being more fully developed. The Department informed us that these scenarios are being used, in a limited way, to review force structure and capital equipment priorities. Nonetheless, capability assessments and decisions on equipment acquisition are currently being undertaken without benefit of fully developed and approved force planning scenarios to determine the needed levels of capability, readiness, sustainability and deployability.

A framework is needed to guide modernization

3.78 Defence policy defines national interests and objectives and states how defence capabilities contribute to them. The Special Joint Committee on Canada’s Defence Policy stated, “It is the government’s responsibility to balance Canada’s security interests within a wider context of policy and national objectives.” It went on to say, “Canada’s military activities must be explained and justified as an essential instrument of government policy.”

3.79 The White Paper calls for the Canadian Forces to be more than a constabulary force but does not clarify what this means. The government’s intention is defined as being able to “fight alongside the best, against the best.” According to departmental officials, the circumstances set out in the White Paper under which the Canadian Forces would be employed were determined by the capabilities that the Canadian Forces could provide.

3.80 In order to link policy expectations to defence capabilities, military forces develop doctrine that specifies the sort of operations they intend to conduct, how they will conduct them, and the kind of forces they will require. Using this doctrinal guidance, force planners identify the structure necessary to meet the commitments the government has outlined in its policy. This framework of policy/doctrine/force structure enables the military to plan

strategically for personnel, equipment and readiness, and to determine whether deficiencies exist. In the Outlook on Force Development, on the Vice Chief of the Defence Staff Internet home page, officials state in a draft document that more work needs to be done to fully link policy with defence capabilities. It states, “Where the current system falls short is in the area of long-term development. The processes, systems and structures to ensure that the long-term development of the Canadian Forces as a whole is synchronized are not yet fully established.”

3.81 In examining the Department’s policy and planning framework, we expected to find clear statements of the military capabilities to be maintained, the force structure and posture to be adopted and the relative priorities placed on capabilities. To plan equipment requirements, the Department needs to be able to address fundamental questions about the nature of the capabilities that must be maintained, how much is enough, and the risks that the military will be called on to face. For example, should the Canadian Forces acquire equipment for mid-intensity operations or focus only on low-intensity operations? And if mid-intensity operations are to be conducted, how does the military intend to carry them out?

3.82 Guidance on the nature of missions and tasks is an important component of planning for the long term. As part of its Management Command and Control Re-engineering (MCCR) initiative, the Department developed an annual Defence Planning Guidance (DPG) document to serve as strategic-level guidance to commands. The DPG document allocates resources, states priorities and identifies the capabilities required by each command. However, it covers only a five-year planning time frame. It does not provide a long-term vision of how the military will operate. In its Outlook on Force Development, the Department notes that a drawback to using the DPG for strategic planning is that it is tied to a five-year budget cycle.

3.83 Strategic guidance is needed to govern the selection of priorities and to allocate resources accordingly. To review force planning effectively and link it with policy, the Department has found it necessary to examine its strategic-level doctrine. The army, navy and air force explained to us that they are reviewing or have recently reviewed their doctrines.

Some Countries Are Better Able to Match Defence Requirements to Resources

3.84 We examined the extent to which other countries could match defence resources to requirements. We reviewed the experiences of the United States, Australia, New Zealand and the United Kingdom.

Other countries are doing better

3.85 Like Canada, other countries have estimated that they need more funding than they have available for military equipment modernization. The United States Department of Defense estimates it needs about US\$60 billion each year for modernization, but it spent only \$45 billion in fiscal year 1997. New Zealand also determined that it could not adequately modernize its forces within its current budget; it received an increase for the next five years. Similarly, Australia and the UK are reviewing their capital spending and both have identified some gaps in capabilities. The Australian Defence Force intends to alleviate funding pressures in the short term by reducing overhead costs, but has identified significant funding deficiencies in the medium term that will require the Australian government to consider an increase in resource allocation. The UK defence policy is under review and resource levels are being assessed.

3.86 Australia, New Zealand and the United States have all completed major assessments of the adequacy of funding for their defence policies. Each country has completed its own defence review to find the right balance of resources and commitments. The US Department of Defense conducted its Quadrennial Defence Review to examine how resources and requirements are connected. This followed its Bottom Up Review to look at the objectives of U.S. defence policy and the resources needed to meet them.

3.87 Canada last reviewed defence objectives and budgets during the 1994 White Paper exercise. At that time, Parliament was involved extensively through its Special Joint Committee on Defence Policy. The Special Joint Committee recommended higher force levels and budgets than those to which the government eventually agreed. Defence planners told us they had preliminary knowledge of 1995 budget reductions when they drafted the 1994 White Paper.

3.88 New Zealand and the United States have an advantage that the Canadian defence management system cannot currently provide — the ability to match outputs and policy goals to resources and to provide performance information on how well goals are achieved. New Zealand has an extensive government-wide process for matching resource inputs to program outputs. Its Chief of the Defence Force and the Minister agree on the deliverables of the Defence Force in a purchase agreement that provides financial statements for each deliverable. Performance reporting informs the Minister and Parliament whether goals have been met. In Canada, department-level performance measurement is close to implementation but is not yet in effect.

3.89 The U.S. Quadrennial Defence Review has been successful in measuring the gap between requirements and resources and proposes a step-by-step action plan its drafters believe will address the gap. Performance information on the readiness of the U.S. military is reported to both the Secretary of Defense and to the President. The U.S. process includes a structured challenge review by an independent panel of experts. This panel has contested the viability of some aspects of the Department's resource plan.

3.90 Canada, Australia and the UK have resource management systems that are not as well developed as those in the U.S. and New Zealand. Australia intends to adopt program budgeting and accrual accounting to track the resources needed to meet the policy requirements. Canada and the UK both intend to adopt accrual accounting in the next few years.

3.91 One commonality evident in the countries we examined was the high level at which outputs and the resources needed to achieve them are reviewed. Annual top-level guidance from the President and the Chairman of the Joint Chiefs of Staff is fundamental to the U.S. process. Reported results of U.S. military performance are challenged by Congress and the General Accounting Office. Congress has a strong role in the annual budget process and is provided with the program information it needs for decision making.

3.92 The system in New Zealand requires the Minister and the Chief of the Defence Force to come to an agreement on what can be accomplished with the resources provided by government; they are bound by that agreement to deliver. Performance is also reviewed by the Treasury. The Defence Force can then discuss with the Treasury the resource gaps that exist. Reports on what has been delivered are audited by the Comptroller and Auditor General, who has confirmed the reasonableness of the reported activities. His Office has advised Parliament that the systems used to collate and report the activities are "sensible, feasible and measurable".

3.93 Canada has recently instituted a new Expenditure Management System to help the government make responsible spending decisions by delivering the programs and services Canadians need in a way that is affordable. Key features of the new system include multi-year funding targets for all departments and annual Performance Reports to Parliament. At the time of our audit, the Performance Report of National Defence was still evolving and contained little performance information that could be used to assess the overall success of the program. Officials estimate that two more years will be required to complete the system.

3.94 The UK House of Commons Defence Committee traditionally reviews the Defence estimates as part of its role to examine the expenditure, administration and policy of the Ministry of Defence. The Committee receives copies of the Government's Statements on the Defence Estimates, Departmental Spending Plans and Departmental Reports, all of which are publicly available, and takes oral evidence from ministers and officials before making a report to the House of Commons. On this basis, it can assess the adequacy of resources and it has raised some concerns.

3.95 In Australia, as in the UK, there are limits on the extent to which parliamentarians can assess spending plans. The Joint Standing Committee on Foreign Affairs, Defence and International Trade is soon to report on its inquiry into the level of funding required by the Australian Defence Force.

3.96 In Canada, the Standing Committee on National Defence and Veterans Affairs reviews the Defence Estimates each year. The new Expenditure Management System is intended to improve parliamentary participation, but better performance information is required.

3.97 Overall, the United States and New Zealand systems appear to do the best job of explicitly linking defence policy or outputs to resources. Australia, Canada and the UK are at about the same stage in improving their top-level resource management systems. All of them are working on implementing accrual accounting, and Canada and Australia are developing performance budgeting or reporting systems. In both Australia and the UK, Parliament has played a more active role in the oversight of defence spending than in Canada.

Conclusion and Recommendations

3.98 While progress has been made in several areas, some of the problems we reported in the past remained unresolved at the time of this audit. National Defence has equipment deficiencies and shortages that limit how well the Canadian Forces can respond to government objectives. Not all the equipment required by the Canadian Forces to correct these deficiencies and to modernize is affordable within the current budget allocations for capital equipment acquisitions. In order to provide the resources required for force modernization, the Department will need to make some difficult choices regarding funding allocations. As other countries have already done, Canada must also ensure that the resources made available for defence match the capabilities that the Canadian Forces are expected to provide.

3.99 **The Department should complete its scenarios, force development framework and strategic assessments with a focus on future force development of the Canadian Forces and the resources it will need to do its job.**

Department's response: This recommendation is being implemented. The Department is already using basic scenarios as a guide to planning, which will be expanded upon by the end of 1998. The Department has also developed a new Strategic Assessment document, which will be updated annually, to guide future defence planning and force development activities.

3.100 **The Department should provide sufficient information on military capabilities, performance and resources to Parliament so that Parliament can better review the Department's Estimates. As in some other countries that are reviewing the performance of their defence forces, the Department should link its defence capabilities to the resources provided so that Parliament can examine whether National Defence's resources match Canada's defence objectives.**

Department's response: The Department is implementing this recommendation. DND's Planning, Reporting and Accountability Structure (PRAS) has been submitted to Treasury Board. This framework clearly links defence activities and their associated resources to desired results.

Department's comment: While Canada requires modern, multi-purpose, combat-capable forces, government policy clearly requires the Department to be cost-effective. The responsible stewardship of Defence resources demands that the Department consider both quality and quantity for Canadian contributions to proposed military operations. The Department recognizes that the Canadian Forces do not always require the most sophisticated or the most modern equipment to fulfil the defence mandate and to provide a meaningful and effective response in

support of Canada's defence requirements. The Department also recognizes that there are many program-related challenges surrounding efforts to develop and maintain a balanced Defence Services Program.

At paragraph 3.66, the Chapter indicates that a significant O&M funding gap exists and that addressing this gap could see some 35 percent of departmental expenditures dedicated to O&M. The Department has committed to living within the resources assigned by Parliament. One solution to the O&M challenge would be to allocate a greater percentage of the defence budget to this area. However, the Department has directed that all elements seek out and implement business efficiencies aimed at achieving more cost-effective use of available resources. In this regard, there has been considerable success and more is anticipated. Although more funds could be directed toward O&M, it is vitally important that balance be maintained in the program in order to satisfy other major cost-drivers such as capital expenditures and personnel.

Paragraphs 3.35 and 3.68 of the Chapter discuss the Griffon helicopter. The report states that the Griffon cannot provide helicopter-mounted direct fire support to ground forces and notes that there may be a significant increase in operating costs relative to the three helicopter fleets it replaced. Regarding helicopter-provided direct fire support, such support would be provided, if required, by other Canadian or Allied aircraft. The Griffon satisfies its intended role in Canada's defence strategy. With regard to costs, the data used by the Auditor General compare aircraft at the end of their useful service lives with a new platform. In view of this, the Department believes that this issue requires more study and an internal review has commenced.

About the Audit

Objectives

The overall objective of our audit was to determine whether the policy and management framework of the Department of National Defence provided long-term, strategic guidance for equipment planning. We specifically asked whether:

- there is an effective framework through which government direction on commitments is translated into plans for equipment modernization for the next 15 years;
- National Defence can achieve the level of equipment modernization necessary to allow the army, navy and air force to meet their policy commitments; and
- the Department has been successful in addressing gaps between capabilities and commitments that have been of concern since the 1970s.

We also reviewed the experience of other countries to determine how well Canada's allies have coped with decreasing defence resources. We studied how the United States, Australia, New Zealand and the United Kingdom assess their defence policy commitments, modernize their armed forces and review performance.

Scope

Our audit focussed on National Defence plans to re-equip the Canadian Forces and ensure that the commitments called for in the 1994 Defence White Paper policy are met. We based our audit on the Department's own identification of equipment deficiencies and capability gaps.

We examined the Department's policy framework used to translate policy commitments into capital equipment plans. We reviewed the new management system employed to provide commands with planning guidance for the development of command-level business and long-term capital plans.

We also examined projects the Department has identified as needed to address capability deficiencies and gaps in meeting policy commitments. We reviewed the supporting documentation for approximately 80 major capital projects in which the army, navy and air force have reported limitations in the equipment they are using, shortages in equipment and risks they face if called upon to use the equipment in conflict situations. For our analysis, we reviewed authoritative departmental documents that had been approved by senior military officials.

Finally, we examined the funding for capital and the resources needed to meet policy commitments.

Criteria

We expected the following:

D a framework in National Defence to link policy, doctrine and force structure to defence capabilities and to identify any capability deficiencies;

- a long-term, strategic view of defence equipment requirements based on assessments of capability, readiness, sustainability and deployability;
- performance assessments by the Department of its ability to meet its policy commitments, based on performance targets and key results expectations, and plans to resolve how targets and expectations will be met in weak areas; and
- a visible priority-assessing and -setting system in place, based on missions and objectives, that allows senior management to choose, at the departmental level, between the competing priority needs of each command.

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Chapter 4

National Defence —

Buying Major Capital Equipment

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National Defence —

Buying Major Capital Equipment

Main Points

4.1 National Defence plans to spend almost \$6.5 billion over the next five years to purchase equipment that Canada's armed forces need to carry out their assigned tasks. As Chapter 3 indicates, the Department's available capital funding may not be sufficient to equip and modernize the force that is currently planned.

4.2 This chapter reports our findings on the management of six major capital projects with a total value of \$3.3 billion.

4.3 All six projects we examined are likely to meet their contract cost and performance objectives. For example, the Eryx anti-tank missile system and the Coyote reconnaissance vehicle appear to perform especially well and have attracted the interest of foreign armed services. Nevertheless, we are concerned about several of the management practices we observed.

4.4 We found that defence policy allows wide latitude in the level of equipment capability required. We noted in the projects we examined that affordability constraints resulted in only low-end capability being purchased, limitations in the number purchased, or both:

- the Maritime Coastal Defence Vessel is acquiring two sets of mechanical minesweeping gear for 12 ships effective only against some types of mines, and has not acquired some of the equipment necessary to patrol effectively in darkness and poor visibility;
- the Leopard C1 tank is being fitted with only an improved sight, although the army had considered a complete upgrade, including the gun and armour, to be the "minimum viable" option;
- the Griffon helicopter cannot meet the army's original lift and communications requirements;
- fewer Eryx missiles and Coyote vehicles have been purchased than were originally intended.

4.5 We are concerned at the extent to which the Department relies on professional judgment in making complex purchase decisions. Management did not conduct adequate analyses to justify its spending decisions for most of the projects we examined. Tactical studies often did not reflect the way officials said they actually planned to employ equipment, were done too late to influence decisions, produced results that contradicted the purchase decision, were undertaken by contractors who had an interest in the Department's decision, or were not done at all.

4.6 In three cases, the Department considered only a single option. In other cases, the options analyses were inadequate.

4.7 Only one project of the six fully met our expectations for a rigorous risk management process. No project we examined has suffered major problems so far because of this, but we identified several instances where better risk management might have improved project delivery.

4.8 Although test and evaluation processes were satisfactory in most cases, for some of the projects that involved commercially based designs, the equipment was not tested under actual operating conditions until after it had been introduced into service. Problems have since been discovered that have affected the operational capability of some of the equipment. The Department is currently working to resolve these problems.

4.9 The Department began a major management renewal program in 1994 that included the capital acquisition process. Because it considered other areas to be more important, it deferred work on capital equipment acquisition and it does not yet have an implementation plan. The Department has begun work on the plan, including three pilot projects. Because equipment acquisition is a government-wide process, the Department is working with Public Works and Government Services Canada, Industry Canada, and the private sector to improve government practices. We believe the departments concerned must develop a plan with definite dates and milestones to complete their reform process.

Introduction

4.10 National Defence's 1997 long-term capital plan projects approximately \$10 billion in total capital expenditures over the next five years. Of this amount, \$6.5 billion will be spent to purchase capital equipment needed by Canada's armed forces to carry out the missions and tasks assigned by the government. While the end of the Cold War and the government's deficit reduction initiatives in recent years have resulted in significant reductions to defence capital expenditures, the defence capital program continues to be the largest in government. Our audit included the six major capital projects described in Exhibit 4.1.

Exhibit 4.1

Projects Selected for Audit

Canadian Forces Utility Tactical Transport Helicopter (Griffon) Project

The purpose of the Griffon project is to acquire 100 helicopters to accomplish national and international utility tactical transport helicopter roles. The primary task is tactical lift of troops and equipment. Other tasks include Base rescue flight, inland search and rescue, Joint Task Force 2 (the federal government's emergency response team), United Nations peacekeeping missions, medical evacuation, major air disaster response, surveillance, drug interdiction, firefighting, assistance to civilian authorities and to the civil power and command, liaison and communications assistance.

The Griffon is intended to replace three aging fleets — the CH-118 Iroquois, the CH-135 Twin Huey and the CH-136 Kiowa. Several helicopter models were evaluated against operational requirements and the Bell model 412hp was selected, to be enhanced with various mission equipment.

The project was approved by Cabinet on 7 April 1992 and by Treasury Board on 8 September 1992. On 9 September 1992, a contract valued at \$754.5 million was awarded for 100 Griffons, a flight simulator, and other equipment, documentation and services. The first helicopter was delivered in March 1995, and the last helicopter delivery was in January 1998. The total estimated cost of the project is \$1.2 billion.

Maritime Coastal Defence Vessel Project

The Maritime Coastal Defence Vessel Project will address the significant deficiency in Canada's capability to defend Canadian ports and coastal waters, particularly the requirement to have sufficient assets in place to ensure, within 48 hours of mine countermeasure effort, that routes from the vital military ports of Halifax and Esquimalt to deep water are free from mines. The project involves the acquisition of 12 Maritime Coastal Defence Vessels (MCDVs) to enter service between 1995 and 1999. The MCDVs will be crewed primarily by the Naval Reserve and, accordingly, are intended to serve as the cornerstone of the Naval Reserve's revitalization.

In August 1988, the government provided approval-in-principle for the acquisition of the 12 MCDVs. Subsequently, Treasury Board authorized resources for project definition activities and the procurement of essential early training equipment during the period 1988 to 1992.

In July 1989, following competitive bidding, two Canadian prime contractors were awarded contracts valued at \$4.5 million each, to conduct project definition studies and submit implementation proposals and offers, including MCDV designs. An interdepartmental evaluation of the two studies and proposals was conducted and recommendations were submitted to ministers on the selection of a prime contractor for the implementation phase of the project. Cabinet approved the project and selected the prime contractor in October 1991. Following contract negotiations, Treasury Board gave effective approval as well as contract approval for the project in April 1992. The total estimated cost of the project is \$708 million.

Leopard Thermal Sight (LTS) Project

On 19 September 1996, Treasury Board gave effective project approval for a thermal sight for the Leopard tank. The thermal sight will be obtained by procuring surplus Leopard 1A5 cast turrets fitted with the EMES 18 thermal sight from Germany, refurbishing these turrets and exchanging them with the welded turrets currently on the Leopard C1. Refurbishment and exchange of turrets has been awarded to a German tank manufacturer while maximizing Canadian content. Surplus equipment will be disposed of through the prime contract. The total estimated cost of the project is \$145 million.

Short Range Anti-Armour Weapon (Heavy) (Eryx) Project

The purpose of the Eryx project is to replace the Carl Gustav rocket launcher as the primary short-range anti-armour weapon of the Canadian Land Forces.

This project represents the first Canada-France co-operation on defence equipment and is expected to serve as a model for future bilateral undertakings.

Effective project approval was granted by Treasury Board on 17 March 1993. An initial \$81 million main contract for the acquisition of the Eryx weapon system was awarded in March 1993. As of 27 June 1997, as a result of follow-on procurement of spares and of the Mirabel thermal imager, the main contract is now valued at \$119 million. In addition, a contract for \$5.4 million was awarded to Aerospatiale to arrange for four

Canadian companies to manufacture components of the Eryx. Three of the four companies are now producing the required parts for incorporation within the weapon system. The total estimated cost of the project is \$179 million.

Electronic Support and Training (EST) Systems Project

The EST Systems Project was approved to define, identify, procure and install equipment necessary to provide the Canadian Forces land, sea and air elements with effective airborne electronic warfare (EW) training. This training will prepare the Canadian Forces for effective operations in an EW threat environment.

A contract was awarded on 1 April 1988 to carry out the definition phase of the project. Preliminary studies revealed that this EST requirement could be met most effectively by a combination of appropriately equipped Challenger CL-600 aircraft, EW training pods carried by CE-133 aircraft (T-Birds), and EW simulators, which will be procured under a separate project.

Negotiations were conducted for the implementation proposal and resulted in the award of an implementation contract on 1 March 1993. A contract to design the aircraft modification to carry the new EW pods on the CE-133 aircraft, install it on the prototype aircraft and produce nine additional modification kits was awarded on 15 July 1994. The total estimated cost of the project is \$203 million.

LYNX Replacement (Coyote) Project

In 1992, the government announced the intention to procure up to 229 light armoured reconnaissance vehicles and associated support for the Canadian Forces to replace the Lynx command and reconnaissance vehicles, which were no longer operationally suitable. The Coyote provides the army with reconnaissance capability.

A contract was signed in March 1993. Total cost approved by Treasury Board was \$883,686,000 budget-year dollars. The vehicles were delivered between March 1996 and January 1998.

4.11 Defence capital acquisition decisions affect how well the Canadian Forces can implement defence policy. The amount and type of equipment they purchase directly affects their ability to carry out their roles, which in turn determines how and where the government can deploy them.

4.12 Major defence capital equipment acquisitions involve several departments (see Exhibit 4.2). National Defence (DND) is responsible for establishing that the equipment is needed. It provides the operational and technical specifications and sets funding and scheduling priorities. The Treasury Board Secretariat provides general policies and guidelines for all aspects of project management. Public Works and Government Services Canada supports the procurement strategy, is responsible for the contracting process and is responsible for ensuring successful product or service delivery to DND through monitoring of the contractors' performance. Industry Canada, in consultation with regional economic development agencies, is responsible for industrial and regional development initiatives to be attached to major capital projects. The three departments together assess options and make recommendations to ministers.

Exhibit 4.2

Organizational Responsibilities for Major Capital Projects

Cabinet	<ul style="list-style-type: none"> • Approves major capital project proposals and funding
Treasury Board Secretariat	<ul style="list-style-type: none"> • Issues capital acquisition policies and guidelines • Provides recommendations and advice to Cabinet on whether major capital projects should be approved, based on an analysis of departmental proposals
National Defence	<ul style="list-style-type: none"> • Defines the requirement • Analyzes options • Provides operational and technical specifications • Sets funding and scheduling priorities • Monitors project implementation by prime contractors
Public Works and Government Services Canada	<ul style="list-style-type: none"> • Assists in developing procurement and contracting strategy

- Manages contracting process
- Ensures implementation of socio-economic objectives

4.13 A defence project management team exists primarily to monitor the progress of the project and inform senior decision makers in the Department of National Defence of any significant difficulties that might jeopardize compliance with the contract. The team also plans and co-ordinates the introduction of the new equipment capability into the forces, including equipment testing and evaluation, user trials and the determination of spare parts requirements.

Focus of the Audit

4.14 Performance shortfalls, schedule delays and cost increases are problems traditionally associated with defence capital acquisitions, which we have reported in previous years. Given the risks and complexities of defence capital equipment projects, we recognize that the total elimination of these problems is not an attainable goal. However, such problems can be minimized if appropriate project management practices are followed. The essential elements of project management are described in departmental and Treasury Board policies and manuals, and include:

- an analysis of requirements that examines costs and alternatives to ensure that cost-effective solutions are matched to valid needs before substantial resources are committed;
- the assessment of risks and the implementation of a project risk management plan;
- testing and evaluation of equipment at various stages to ensure that technical specifications and user needs are being met;
- sound project monitoring and reporting practices; and
- human resource management.

4.15 Our audit included all these aspects of project management as well as a comparison of the Department's practices and renewal efforts with best practices elsewhere. More details on how we conducted the audit are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Previous audits showed the need to improve the capital equipment acquisition process

4.16 In previous audits, we found that the Department's process for acquiring major capital equipment needed to be improved.

4.17 In 1992, we reported that DND had recognized the need to simplify and streamline its major capital acquisition process, which had become unnecessarily complex, process-driven, costly and no longer appropriate for the management of the defence capital program. Our 1994 chapters on Information Technology and Infrastructure Management pointed to continuing problems with the Department's project and program management systems, despite attempts to improve them. Our 1994 follow-up chapter also noted that while the Department has generally concurred with our recommendations, it has been slow to implement improvements. We also expressed our concern

that the actions it has taken may be inadequate to address the problems with the project and program management systems.

4.18 Many of the problems associated with the purchase of major capital equipment that we found in our 1984, 1987 and 1992 audits continue to affect today's defence capital acquisition projects. The Department recently confirmed the persistence of these problems in a re-engineering study that examined capital project management from end to end. The study stated that capital acquisitions continue to be adversely affected by:

- an excessively complex and labour-intensive acquisition process;
- inadequately trained project managers;
- insufficient resources and underestimation of supportability costs;
- an ineffective and untimely staffing of project management offices;
- gaps and overlaps in project management responsibilities;
- poor procurement practices;
- poor application of program and project risk evaluation and risk management principles;
- lack of an integrated information system; and
- inadequate project management information.

These problems are recognized by the Department and are being addressed in the many ongoing change initiatives within DND. However, the introduction of new project management processes will require time to introduce new skills, training programs to operationalize the skills and a continuous program of cultural change to realize full implementation.

The Department has made a commitment to renewal

4.19 In December 1994 the Department embarked on a renewal program to explore innovative ways to acquire and maintain equipment. This was undertaken in response to the government's Program Review, budget reductions and the Defence White Paper, which directed the Department to have less infrastructure, fewer people, fewer command headquarters and more affordable equipment. Management renewal and business process re-engineering were the major strategies departmental management adopted to cope with budget reductions and improve the effectiveness and efficiency of operations. The management renewal program's principal objective is to allocate a higher percentage of available resources to operational forces and less to support and administrative overhead. The major capital project acquisition process is one of the key areas targeted for reform under the program. The Department's overall strategic plan is to reform the acquisition process so that it incorporates best worldwide practices, identifies new acquisition concepts, reduces processes that drive requirements, seeks industry life-cycle support solutions, and develops training for the project management community. It now plans to have in place a plan of action by 1999 to implement a new acquisition process that could:

- ensure a highly effective and efficient project management capability;
- reduce the average cycle time of the process from its current average of 12 years to five years or less; and

- reduce by 50 percent from the April 1994 baseline the incremental project management personnel resources required for project management.

Changing the Way the Department Buys Equipment

Departmental acquisition renewal efforts

4.20 At the end of 1994, the Department established a Management, Command and Control re-engineering team to evaluate every activity in the Department, identifying those that could reasonably be eliminated and determining the best way of accomplishing those that remained. The capital acquisition process was one of the areas reviewed.

4.21 National Defence and Public Works and Government Services Canada (PWGSC) had set up a working group in June 1993 to study and evaluate the major capital projects process. The study had identified key areas for improvement, which became part of the basis for redesigning the key processes that guide the approval and conduct of major capital acquisition. From this, National Defence began its re-engineering studies. Their purpose was to renew all aspects of the materiel acquisition and support (MA&S) function and to develop a comprehensive plan for re-engineering the capital equipment acquisition process.

4.22 In February 1996, the re-engineering team completed its review of the major capital acquisition process and made recommendations dealing with both the Department's internal processes and government-wide processes affecting capital acquisitions.

4.23 To date, the Department has implemented the recommendations of the re-engineering team that were directed at its own internal project approval processes. However, the roles and responsibilities of other key players in the capital acquisition process, such as the Treasury Board Secretariat, Public Works and Government Services Canada and Industry Canada, are being examined as part of the government-wide acquisition reform initiative.

4.24 Departmental officials indicated that the primary focus of their reform efforts to date has been on support services and the procurement of supplies, spare parts, and services. They selected this area first because they believed it would provide the highest payoff for their efforts. The progress made thus far includes the adoption of innovative contracts for certain types of spare parts, and the establishment of several pilot projects.

4.25 The Department has recently shifted its focus to reforming the capital acquisition process. To this end, an oversight committee of officials from DND, PWGSC, Treasury Board Secretariat and Industry Canada has been established to harmonize and implement various procurement reform initiatives across government. National Defence officials told us that industry representatives have also been engaged to seek consensus on new approaches to government procurement. Through these efforts, DND expects to achieve government-wide acceptance and adoption of DND renewal initiatives such as the use of pre-facilitated contracting, the commercialization of non-core activities, and longer-term partnering arrangements and contracts. The work of the oversight committee is expected to determine the extent of change to current government procurement policies and practices needed to fully exploit the benefits of new ways of doing business.

The Department needs to complete an implementation plan for re-engineering the capital acquisition process

4.26 In general, we found that the reform of the capital acquisition process is still in its early stages and progress in implementing change has been slow. This is understandable, given the complexity of the issues involved and the long-term nature of the problem. Also, because a major portion of the acquisition function remains outside the Department — particularly the contracting function — the Treasury Board Secretariat and Public Works and

Government Services Canada also need to become involved in order to make the required changes. Departmental officials indicated that valuable lessons in acquisition reform have been learned from DND's participation in a bi-national capital acquisition project known as the Region and Sector Air Operations Centres Modernization (R/SAOC), a project with the United States Department of Defense. This \$93 million project is being managed in accordance with the U.S. Department's streamlined acquisition process and involves the modernization of the North American Aerospace Defense (NORAD) computers, communications equipment and infrastructure. This project and two others, the Materiel Acquisition and Support Information System (MASIS) project and the Light Utility Vehicle (LUV), have recently been designated as pilot projects in the government-wide capital acquisition reform initiative. Some acquisition reform concepts, such as the purchase of available off-the-shelf equipment, have been tested on the Griffon helicopter project and the Maritime Coastal Defense Vessel project.

4.27 The Department has developed a plan for re-engineering the capital acquisition process, but it has not fully developed its implementation plan for the changes that have been proposed. The re-engineering plan called for the complete development of an implementation plan by the end of September 1997. The date has now been changed to March 1998.

4.28 Our audit findings described later in this chapter demonstrate that there is a need to continue the reform of the capital equipment acquisition process. Unless the Department takes action to correct the deficiencies reported in this chapter, the problems already reported will continue to affect future capital equipment acquisitions.

The human resource capacity to manage major projects is at risk

4.29 The Department is attempting to re-engineer its work processes in reaction to the forced downsizing of its headquarters and support staff. Downsizing was required because of budget cuts necessitated by the government's Program Review. Prior to 1994, the management of major equipment projects employed the equivalent of 1,415 full-time staff. The Department's year 2000 target for project management staff is 675 employees.

4.30 As we have already noted, the Department has not yet determined how it will re-engineer the equipment acquisition process. Although there is no assurance that the downsizing process will leave enough staff with the right skills to manage complex projects, the Department has reduction strategies in place to ensure that people with skills for which it anticipates a future need are not targeted under reduction activities. Also, as part of the Materiel Acquisition and Supply re-engineering efforts, the Department is attempting to map out skills, knowledge and abilities generated as new re-engineered processes are introduced.

4.31 While the lack of planning creates a significant risk, the Department is aware of the problem. The Department has integrated human resource planning into its business planning process. It is also responding to emerging gaps with initiatives such as a civilian procurement officer development program. However, results of these initiatives will be evident only over time, and the efforts need to be sustained.

4.32 The Department should ensure that it has assessed the skills required to manage major equipment acquisitions, has a human resource plan in place, has its new recruitment and development programs operating and has information systems to support human resource management.

Department's response: The Department is pursuing a number of initiatives to address this recommendation. Specifically, the re-engineering of the Department's materiel acquisition and support processes allowed DND to clearly identify those skills, knowledge and abilities required for project management. The Department can now better determine where new recruitment and development programs are needed and refine internal training and development programs for existing staff. The DND Materiel Civilian/Military Information System currently supporting the Department's human resources planning and data base requirements will be replaced by PeopleSoft, which will better address the Department's human resource management needs.

Canadian industry has concerns about the Department's capital acquisition practices

4.33 As part of our audit, we held a one-day symposium with executives from major defence equipment contractors to identify and discuss best practices in defence capital acquisition. The industry executives indicated that they were dissatisfied with the government's current process for buying major capital equipment. They suggested eliminating duplication of effort among the various federal departments involved in managing the acquisition process, having better-trained project staff, reducing turnover of federal project staff, adopting a less adversarial approach in the administration of contracts, adopting a partnership approach between government and industry, reducing unnecessary paperwork, and reducing the use of military specifications. The industry representatives we spoke to also do business with the United States Department of Defense. They believed that National Defence's renewal efforts are not as far advanced as those of its American counterpart. They also indicated that they have noticed little or no change in the way the Department acquires major capital equipment.

THE UNITED STATES EXPERIENCE

THE UNITED STATES DEPARTMENT OF DEFENSE IS REPORTING SIGNIFICANT SAVINGS FROM RE-ENGINEERING ITS EQUIPMENT ACQUISITION PROCESS

Between 1991 and 1995 the US Department of Defense procurement budget was reduced by almost 40 percent. Recognizing that it could no longer afford to buy weapons systems as it had in the past, in 1994 the Department of Defense began broad-based changes to its acquisition and contracting processes.

Two of the areas that it is emphasizing are the requirements determination process - "what to buy" - and the acquisition process - "how to buy".

In deciding "what to buy", Defense's efforts are focussed on greater reliance on commercial products and processes, and more timely infusion of new technology into new or existing systems.

In considering "how to buy", Defense has focussed on increasing teamwork and co-operation, encouraging risk management rather than risk avoidance, reducing reporting requirements, and reducing layers of review and oversight that add no value. It has also initiated a series of acquisition pilot projects to demonstrate that the use of commercial practices and processes can result in significant cost reductions in military equipment acquisition programs.

The projects were given regulatory relief from certain statutes, regulations, and internal Defense acquisition directives.

Defense officials have reported significant progress in implementing regulatory and statutory acquisition reform and achieving significant cost and schedule benefits - from 15 to 50 percent. The five pilot programs, which were selected in December 1994 and designated under the provisions of the *Federal Acquisition Streamlining Act (FASA)* of 1994, are the Joint Direct Attack Munitions (JDAM), Fire Support Combined Arms Tactical trainer (FSCATT), Joint Primary Aircraft Training Systems (JPATS), Commercial Derivation Engine (CDE) and the Non-Development Airlift Aircraft (NDAA).

Officials have reported significant gains in efficiencies for these pilot projects as a result of reducing the use of military standards, contract data requirements, the length and complexity of solicitations, and source selection cycle time.

The JDAM program, for example, projects a 34 percent reduction in development time and a unit cost saving of over 50 percent, with an associated total production cost avoidance of \$2.9 billion. The JDAM program office attributes these dramatic savings to the commercial-style environment created by FASA. The JDAM program manager capitalized on the "commercial environment" to procure proved technology with reduced oversight (an average 85 percent reduction in in-plant oversight) and streamlined procurement documentation (29 data requirements and a two-page statement of work with only interface specifications and not military standards).

The Army's FSCATT program manager also reported significant cost and schedule benefits. Streamlined procurement efforts completely eliminated unique military standards, while reducing the number of data requirements from 56 to 7. In-house source selection hours were slashed by 30 percent. Development time and costs were reduced by 33 and 34 percent respectively.

JPATS acquisition reform initiatives made possible a 50 percent reduction in military standards and a 60 percent reduction in contract data requirements. These efforts resulted in a reported 12 percent reduction in development time and a 50 percent savings in program office staffing.

It should be noted that these results have not been independently validated by outside bodies such as the General Accounting Office (GAO). Nevertheless, the results of the pilots indicate that significant savings are possible through re-engineering the capital acquisition process.

4.34 Officials noted that they had met with industry three times since June 1997 and had heard many of the same concerns expressed. They believe their re-engineering efforts will address many industry concerns, but noted that government-wide regulations and practices may be affected.

4.35 National Defence, in consultation with other key departments and agencies involved in the capital acquisition process — particularly Public Works and Government Services Canada, Industry Canada and Treasury Board Secretariat — should continue their efforts to:

- **develop an implementation plan for re-engineering the capital acquisition process that clearly indicates the nature of the changes required, targets for performance improvement, and the approximate time frame for meeting the targets;**
- **select pilot projects to try out the re-engineered process;**
- **establish a set of meaningful performance measures to assess the performance of the revised process and determine whether it will achieve the desired results; and**
- **develop a human resources plan that identifies the types and quantities of skills needed to manage major capital projects.**

Department's response: In the pursuit of procurement reform, the Department has developed a draft "Acquisition Reform Guide", which captures new acquisition concepts and is being developed into a detailed acquisition best practices implementation guide. This Guide will contribute to the development of the implementation plan for government-wide procurement reform, and its Materiel Acquisition and Support Information System (MASIS) project is a key pilot related to the government's Benefits-Driven Procurement initiative. The target date for selection of other pilot projects and the supporting departmental implementation plan remains the end of April 1998.

The Department also believes that performance measurement is essential and is now incorporated in departmental planning. Public Works and Government Services Canada has made significant progress in developing performance measurement relating to acquisition project management that complements DND efforts to develop performance measures related to the materiel acquisition business. With respect to a human resources plan, as previously mentioned, DND has several activities in progress to formalize project management skills and develop project managers.

Requirements and Options Analysis

Why requirements and options analyses are important

4.36 The government's policy set out in the 1994 Defence White Paper reaffirms the need to maintain multi-purpose, combat-capable sea, land and air forces that will protect Canadians and project their interests and values abroad. The policy also states that affordable equipment will be purchased so our military will have the means to carry out their missions.

4.37 Determining requirements and analyzing the available options are important aspects of the major capital project acquisition process because they set the stage for acquiring affordable equipment. It is at this stage that trade-offs are made among factors such as quality, service, cost and socio-economic considerations. In complex acquisitions, a cost/benefit analysis may balance technical quality against such factors as initial and operating costs, economic life, service, maintenance and repair.

4.38 DND's capital equipment requirements can range from modernization of existing equipment through parts replacement to replacement of old equipment with new equipment designed to do the same job, to completely new families of equipment designed to do something that has never been done before.

4.39 We expected to find that all major capital equipment requirements would be based on continuing assessments of current and projected military capabilities, taking into account Canadian defence policy and changing military threats. We also expected that adequate tactical analysis would be conducted to define the type, quality and quantity of equipment required. Finally, we expected that options and alternatives that could fulfil those needs would be identified and their cost effectiveness analyzed before a specific solution was selected.

4.40 Our audit found that the 1994 White Paper allows officials a wide latitude to determine "how much is enough." It provides only general guidance by calling for multi-purpose, combat-capable forces that can fight "alongside the best, against the best." Officials told us that they interpreted this to mean capability anywhere from combat tasks, like peacekeeping, to war fighting such as the Korean War.

4.41 We found significant gaps in the analysis of requirements and options before purchase decisions were made. No project in our sample met our criteria entirely, and most met few criteria.

Military requirements were poorly assessed

4.42 We attempted to examine links among policy, threat assessments and the tactical analyses used to justify each purchase.

4.43 Policy. For the most part, the projects we examined were linked to national policy requirements.

4.44 **Threat assessments.** We expected to find a threat assessment that would define the opponent against which a system might be used, and the weapons opponents might use. We expected to see a range of plausible threats developed in order to allow for uncertainty about where the Canadian Forces might be employed.

4.45 Several threat assessments for projects that were initiated during the Cold War era were not updated to reflect the post-Cold War threat climate. We noted that two of the six projects we audited did not carry out a formal reassessment of the threat.

4.46 The Electronic Support Training System project included a threat assessment in its 1988 Statement of Requirement. This assessment was very thorough in depicting the threat of enemy equipment and tactics at the time it was written. There was a comprehensive list of radar and communications "victim systems" that the project system must attempt to jam. However, the project will take a decade to field and the threat continues to evolve. The Department has recognized the evolution of the threat but maintains that risk and affordability concerns have prevented the project from delivering a more current training capability. Departmental officials state that the electronic system is software-based and therefore has the inherent flexibility to be adjusted to future needs.

4.47 **Tactical analysis.** The most significant gap we discovered in defining the military requirement was in tactical analysis. A tactical analysis is necessary to determine the optimum characteristics of equipment and to discover whether technological improvements provide actual combat value.

4.48 The \$1.2 billion Griffon helicopter project replaces three aircraft: two fleets of utility and one fleet of light observation helicopters. While it appears that there was a review of how a single aircraft could replace two types — utility and light observation — that have widely varying characteristics and capabilities, departmental officials could not produce a copy of it. The Statement of Capability Deficiency for the project set a pacing task of three

simultaneous troop lifts from three locations to a position 500 kilometres forward in 24 hours. We found correspondence questioning the realism of this pacing task, and no substantiation for the distance and timing goals.

4.49 A study conducted in August 1992 — after the Department had selected the aircraft it wished to purchase but before Treasury Board approval on 8 September 1992 — indicated that the helicopter purchased could not meet the lift requirements for this task with the number of aircraft specified. In addition, analysts found that two fuel caches, not one, would be required to perform this task, putting in doubt the realism of the pacing requirement. The study also found that the load capacity of 3,100 pounds specified in the Statement of Requirements of the contract was short of the 5,000 pound minimum and 10,000 pound optimum capacity to transport an artillery gun or engineer equipment. However, the Department stated that the priority was tactical lift. Also, because of lift limitations, the aircraft selected would have to make 460 sorties from 24 helicopters to evacuate the casualties expected in a mid-intensity conflict and to provide logistic airlift. The study stated this was “an unrealistic proposition.” Departmental officials told us that the shortfall in lift capacity might be provided by allies. They also said that the requirements for casualty evacuation and logistic airlift were staff estimates from the Cold War era and may now be excessive, but offered no updated figures. We concluded that the tactical studies did not adequately justify replacing two divergent aircraft types with one, and that they were concluded too late in the process to affect decision making. In addition, the studies called into question the suitability of the aircraft that was selected.

4.50 The Leopard Thermal Sight project is intended to improve the combat capability of Canada’s Leopard C1 tank by increasing the crew’s ability to see in the dark and in smoke. Tactical analyses conducted to define the Leopard tank upgrade did not support the decision to improve the night vision system alone. A major simulation war game conducted in 1993 concluded that even an improved Leopard C1 tank would not provide meaningful improvement to the army in a mid-intensity conflict. The study found that while the M1A1 Abrams tank would significantly increase the effectiveness of a battle group, an improved Leopard C1 tank would not. According to the study, “There was no significant difference in the entire battle group’s performance . . . [it] failed to withstand an attack or mount a successful assault.” The only other study by the Department was conducted by the manufacturer and thus cannot be considered independent. The objective of that study was to determine how the Leopard C1 tank should be upgraded to successfully engage the most likely type of enemy tank. The study found that a totally upgraded Leopard C1 could defeat the specified enemy tank in a one-on-one duel, but pointed out that this was a limited and unrealistic scenario; further studies that included anti-tank missiles and helicopter gunships were needed. In our opinion, the studies undertaken did not provide substantiation for the decision to upgrade the Leopard C1 night vision system.

4.51 Departmental officials told us that the first study — which examined a Canadian Forces battle group in a main force battle at the “high end” of mid-intensity conflict — did not reflect the way they intend to employ Land Force combat units. They maintained that the Leopard C1 with a thermal sight would provide essential capability that would permit land forces to perform useful tasks in a broad spectrum of operations other than war and war fighting. They further said that they maintained close contact with NATO allies and that further formal studies were not necessary. They also pointed out that Belgium, Denmark and Greece have similarly upgraded their Leopard 1 tanks.

4.52 The tactical concept for the Coyote armoured reconnaissance vehicle was based on a number of studies, including the simulation that examined the Leopard C1 tank. The simulation study concluded that vehicles armoured to the same standard as the Coyote could not withstand the enemy fire they would encounter at the high end of mid-intensity combat without support of heavy forces. It concluded that this type of vehicle could not be considered for a “general purpose” combat force; forces so equipped should be considered light units with limited capabilities and be given only limited tasks. A battle group equipped with Coyote-type vehicles was regarded as likely to be suitable for peacekeeping but not necessarily for peace-restoring operations.

4.53 Once again, departmental officials disputed the validity of some aspects of this study. They said that the study scenario employed Canadian troops equipped with lightly armoured vehicles in a more demanding mission than would be appropriate, and the tactical employment of the Coyote vehicle required it to perform tasks for which

it was not designed. In addition, heavier weapons systems such as attack helicopters, multiple launch rocket systems and close air support, which would be available from higher formations, were not included in the study. Officials told us they lacked the time to conduct further studies after the purchase decision was made. They further pointed out that the Coyote vehicle is performing well and is highly regarded by Canada's allies.

4.54 The Department determined the number of vehicles needed by referring to existing doctrine based on reconnaissance by soldiers with binoculars rather than complex sensors able to see almost 10 kilometres. The number of vehicles was then reduced as cost estimates increased. The number of vehicles needed was not determined on the basis of any tactical study. At the time of our audit, the Canadian Forces were still carrying out field trials to determine how to best employ this vehicle.

4.55 The key tactical considerations for the Eryx short-range anti-tank missile are that it be able to penetrate tank armour from all directions, engage targets at an effective range of up to 600 metres, and be fired from an enclosed space. Although these requirements were included in doctrine, we were unable to find adequate substantiation for the doctrine itself. In its internal documentation supporting the project, the Department claimed it had completed a study that indicated "unequivocally that only a guided system" had the accuracy it required. That study, however, was prefaced with comments recognizing that "a thorough examination of the subject was not possible", there were "insufficient data on several subjects", and "several aspects were not considered in detail." The study makes no conclusions about guided or unguided missiles, nor does it substantiate any particular range requirement. The study calls into question the cost effectiveness of all man-portable anti-tank weapons. We found no substantiation of the validity of the criteria used to restrict the choice to a single missile, as presented to senior departmental officials. However, departmental officials told us that although appropriate analyses had been carried out, the documentation was no longer available. The results of recent tests indicate that the Eryx's performance exceeds departmental expectations and satisfies their requirements.

4.56 Doctrine and additional studies, as well as most other documents supporting the project, assumed that a medium-range missile would also be fielded. However, the Department does not have a medium-range missile as it was considered to be unaffordable. Departmental officials told us that they have adapted their existing long-range missile for medium-range use instead of purchasing a new medium-range weapon. We did find adequate studies examining the number of firing posts required and the basic optimum ammunition load. But the Department did not study how the basic optimum load of six missiles per section could be carried in the field. At present, a section can transport only three missiles.

The Department relies heavily on professional judgment

4.57 Overall, officials expressed the opinion that their corporate professional judgment was an adequate basis for major procurement decisions. They pointed to the results achieved: the Eryx and the Coyote, for example, are highly regarded by some foreign forces. Nevertheless, we remain concerned that complex acquisitions are based so heavily on judgment, that studies performed are poorly matched to plans for employing the equipment, and that studies often do not support the selection of the equipment that is acquired.

Options analysis was inadequate

4.58 Once the military requirement has been clearly specified, the Department must identify ways of meeting it and the relative cost and effectiveness of each alternative. It is very important that all reasonable alternatives be identified and considered, or assessment of options will be an empty formality. We concluded that only two of the six projects we examined had identified all reasonable options. None had conducted an adequate cost-effectiveness analysis.

4.59 In three cases — the Coyote vehicle, the Eryx missile and the Challenger aircraft acquired to carry Electronic Support Training equipment — only a single option was considered. In the case of the Coyote vehicle,

the Assistant Deputy Minister (Materiel) and the Deputy Chief of the Defence Staff directed that the Light Armoured Vehicle (LAV 25) be purchased as the “threshold requirement.” No study of alternative vehicle types was undertaken. Since the direction specified the number of vehicles to be purchased, the possibility of filling part of the requirement with aircraft was not examined even though this was then, and is still, Canadian Forces doctrine. Departmental officials told us that some major components of the Coyote were acquired through a competitive process. They further stated that while satisfying the operational requirement is paramount, the government procurement process ensures that broader government and economic objectives are supported.

4.60 As we have already noted, the stated requirements for the short-range anti-tank missile reduced the choice to a single option. In its internal documentation supporting the project, the Department indicated in August 1987 that a study had demonstrated that only a guided missile could fill the requirement. Moreover, it said, a survey of “potential contenders” by Defence staffs had “confirmed” that there was only a single missile “in the Western world” capable of meeting this requirement. We found that the study did not support the Department’s contention, and we could not find the survey on which this directed purchase was based.

4.61 A major component of the Electronic Support Training system is the aircraft used to carry the electronic simulators, jammers and countermeasures equipment. The Challenger aircraft was selected without a competitive process. Our 1987 Report commented fully on that acquisition. This is the aircraft that will carry the electronic simulators, jammers and countermeasures equipment that the Electronic Support Training system comprises. The aircraft is not a direct component of the project.

4.62 In the three other projects we audited, options analyses had been conducted but we found them to be inadequate. The Griffon helicopter project did not adequately consider all options. A 1992 departmental cost/benefit study concluded that acquiring a single fleet of utility tactical transport helicopters would prove less costly than upgrading and maintaining a mixed fleet. While the study presented a graph that supported this conclusion, departmental project staff could not provide the source data used to create the graph. Because we were unable to verify the validity of the source data, we were unable to affirm the study’s conclusions although they were generally supported by analyses presented to us by the project staff. While we did not undertake a full cost/benefit study, our own review of operations and maintenance costs based on the DND Cost Factors Manual and available data for the new fleet indicates that the new helicopter may cost 20 to 40 percent more to operate than the aircraft it replaces. We found no evidence that the Department consulted more than one company to explore the alternative of leasing aircraft. Ultimately, the aircraft were purchased from that company. Prior to the award of the contract, the manufacturer was asked to determine whether used helicopters were available, and it reported that it was highly unlikely sufficient aircraft could be found. Other new aircraft were excluded on the basis of higher initial capital costs, even though their larger size meant that fewer would have been required. Life cycle costs for other aircraft — which might have been lower — were not considered. In short, the options analyses were too limited and relied in part on the potential vendor.

4.63 Departmental officials told us that developing a comprehensive options analysis for the Leopard Thermal Sight project had been precluded by affordability concerns. Options initially considered were to maintain the status quo, purchase a new tank, acquire a used tank, acquire a used armoured vehicle, or upgrade the Leopard C1. The Department determined that the thermal sight was the only affordable option. However, we could not find any studies to support this option as the best use of the army’s money. The Department maintains that the addition of the thermal sight addressed the most critical deficiency in capability and was the most significant improvement possible with the limited funds available.

4.64 The options analysis in 1986 for the Electronic Support Training system mission suite had rejected the leasing of equipment, even though no actual solicitation to industry was made. By 1992 the United States Air Force, the United States Navy and the British Royal Navy and Royal Air Force had all opted for contracted-out service or had placed the equipment on ships, rather than on small aircraft that would have required extensive engineering and modification to accommodate it. A 1992 Canadian Forces review considered contracting, but concluded that there was no Canadian company able to provide the service and that acquiring the capability was the preferred option.

However, no attempt was made to cost the contracting option. Finally, in considering various equipment options, the Department estimated the percentage of the training requirement each would meet. The preferred option was considered capable of meeting 75 percent of the total requirement. We could not determine how these percentages had been derived. Life cycle costing was conducted, but there was no supporting documentation available that we could examine.

4.65 We are concerned about the weakness of nearly all the requirements and options studies that we examined. Particularly troubling are the number of directed purchases, the tendency to override results of tactical studies that challenge the accepted option and the conducting of tactical studies after decisions have been made.

There is a drift to low-end equipment performance

4.66 The ultimate goal of defence procurement is not to buy platforms — ships, vehicles and aircraft — but to build defence capability. While the number of platforms is important, vehicles that cannot do the job in combat do not represent good value for money. Our audit indicates that three of the six projects in our sample are resulting in the purchase of systems with low capability.

4.67 Chapter 3 showed that unless action is taken, the defence budget will continue to be overextended, and the force structure the Department is attempting to build may not be affordable at current levels of support efficiency. This appears to be a powerful contributing factor in the purchase of low-capability systems. It seems that the requirement so greatly exceeds the funds available that officials do not carry out rigorous analyses of requirements and options. Instead, they attempt to spread funds across as many requirements as possible, perhaps in the hope that at some point in the future the platforms it purchases can be outfitted. In the meantime, the Canadian Forces possess many platforms that cannot be fielded in mid-intensity conflict.

4.68 The following cases illustrate the problems that we found.

4.69 Utility tactical transport helicopter. The Griffon helicopter perhaps best illustrates the implications of not enough money and inadequate analysis. Canadian Forces doctrine describes the role of tactical aviation as supporting land forces by providing aerial firepower, reconnaissance and mobility. Four types of helicopter are identified to carry out these missions — attack, light, utility and transport. Canada has never owned attack helicopters, but had a fleet composed of the other three types. Light and transport helicopters were eliminated in the early to mid-1990s to save money, leaving two types of utility aircraft. The Department's strategy was to fill the light, utility and transport requirements with a single aircraft because it believed that maintaining three different aircraft would be unaffordable. We did not find full substantiation for the assumption that money would thereby be saved.

4.70 The Department further elected to purchase a customized product based on a commercial-pattern helicopter rather than a military aircraft, with the rationale that acquiring the more expensive military aircraft would mean it could not afford the number of aircraft it needed.

4.71 Our audit focussed on how the Department determined its operational and performance requirements for a helicopter. We did not audit whether contract specifications were met. The helicopter it purchased has limitations in certain military roles, including the following:

- **Inadequate lift.** The aircraft statement of requirements called for the helicopter to be capable of carrying a 3,100-pound payload over a distance of at least 100 kilometres. This requirement was specified to meet the army's need to carry its new lightweight howitzer. Because the howitzer actually delivered is heavier, it can be carried only about 25 kilometres instead of the 100 kilometres expected. The Department's own study indicates that when troops are to be transported, one additional helicopter per squadron would be needed to deploy a company group simultaneously. In addition, the study points out that making the number of daily sorties required to meet forecast

rates of logistic lift and casualty evacuation would be unrealistic. As we have already noted, departmental officials state that these forecasts are based on staff estimates drawn from the Cold War era and may be overestimated.

- **Limited reconnaissance capability.** According to the Commander of Tactical Aviation Group 10 (10 TAG), “. . . a utility helicopter is not optimized for the conduct of reconnaissance missions, the direction and control of fire, and observation operations in a hostile environment. . . although if properly manned and equipped it could perform these tasks.” Departmental officials indicate that some equipment has been acquired to enable the Griffon to conduct reconnaissance and perform operations in a hostile environment. They say there are plans to buy more equipment in the future that will enhance the reconnaissance capability of the aircraft.

- **Some defensive systems remain under development.** While adequate equipment for air crew protection appears to have been procured, some defensive equipment remains under development and would have to be acquired from allies in the event of sudden deployment. For instance, the radar warning receivers delivered initially are being replaced to procure a more technologically advanced product, combining the features of both radar and laser warning receivers. In the interim, departmental officials told us, a radar warning receiver could be obtained on short notice from allies. Departmental officials have said that the statement of requirements for an enhanced optic system for reconnaissance, surveillance and observation tasks needs to be refined, but no funds have been identified. At this point, no weapons have been provided other than a door gun. Departmental officials have not endorsed the need to further arm the helicopter.

- **Lack of communications assistance capability.** The Griffon has no radio rebroadcast capability. This feature is also expected to be delivered under a separate project, which is experiencing significant delays.

4.72 As a result of defensive systems and communication deficiencies, the Griffon at this juncture could provide only the capability required by Op Plan Sabre, the plan to meet the White Paper requirement to deploy an army brigade anywhere in the world in mid-intensity conflict, with assistance from allies.

4.73 Maritime Coastal Defence Vessel. The Maritime Coastal Defence Vessel represents an acquisition strategy similar to that for the Griffon helicopter — a platform built to civilian standards and fitted for, but lacking, the necessary mission kit to satisfy the remote mine hunting capability. When it requested approval of the project, the Department informed Treasury Board that it was following a design-to-cost strategy and that the full requirement — specifically, the remote mine hunting capability — was not affordable. The project received approval on that basis.

4.74 For a fleet of 12 ships, the Department will acquire four sets of route survey equipment to allow it to map the ocean bottom, two sets of mechanical minesweeping gear effective against only those types of mines tethered to the ocean bottom, and one bottom object inspection vehicle intended to be used for training purposes. This equipment could potentially have to be used to clear both Halifax and Esquimalt and would be able to remove only tethered mines. The vessels also lack bow thrusters to position the ship during mine hunting and clearance operations, as well as spare towfish required for route surveying. The bow thrusters will be essential if a remote mine hunting system is eventually acquired. Only three ships will have fully operational degaussing systems capable of reducing the magnetic signature of their steel hulls. Departmental officials have informed us that bow thrusters and additional degaussing equipment were not initially provided by the project due to affordability trade-off decisions; some of this equipment may be provided later if the project has sufficient funds available at its completion.

4.75 At present, the Department cannot meet the goal of being able to clear a harbour within 48 hours. Despite the fact that this goal was the established priority in the mine countermeasures initial requirement, departmental officials told us that it is a long-term goal, one to which this project contributes. A remote mine hunting system is under development as a separate project but will not be available until well after the year 2000, by which time a significant portion of the ships' service life will be used up. In spite of these deficiencies, officials told us they believe that the project has attained its goal of providing a “credible” mine countermeasures capability.

Departmental officials have informed us that “credible” should be interpreted to mean that “whatever limited capability was acquired must be effective, that is credible, within those limits.”

4.76 The coastal defence vessel is also tasked with patrol and surveillance. For the most part, we found the vessel capable of performing these missions. We found that the original “essential” requirement for a data link system integral to the ship’s command and control system was eliminated because it was not affordable. Officials now state that tactical data links are not essential for the types of operations planned for these vessels. They also lack passive electronic surveillance equipment to perform in the surveillance role, although it was previously regarded as “essential”. This is an electro–optical vision capability to operate effectively in darkness and poor visibility. The capability was never acquired. The passive electronic surveillance capability is partially met by Very High Frequency (VHF) direction–finding equipment.

4.77 Leopard C1 tank thermal sight. The Department began by considering the total upgrade or complete replacement of the Leopard C1 tank. However, this would have cost over \$300 million. The total upgrade was described as necessary to meet the “minimum viable operational requirement”. Affordability limitations required the reduction of the project to only the thermal sight. According to the sponsor’s submission to the Program Control Board of the Department, “The constrained option [was] preferred solely because of cost factors.” Departmental officials maintain that the addition of the thermal sight will enable the tank to perform some meaningful tasks in lower–end mid–intensity operations.

4.78 Eryx missile system. The Department believed that equipping all close combat field forces and the associated sustainment forces and infrastructure with the Eryx missile system would provide the optimum operational capability. This option would have required the purchase of 1,050 units at a total cost of \$436 million. However, this option was judged unaffordable. Consequently, the Department had to compromise and chose to purchase only 425 units at a cost of \$179 million, to equip close combat manoeuvre forces for infantry roles and the associated training infrastructure.

A stronger role for operations research is needed

4.79 Operations research is “a scientific method of providing executive departments with a quantitative basis for decisions regarding operations under their control.” Operations research attempts to apply scientific methods to the solution of military problems. We found that the Department’s operations research staff had conducted studies on all of the requirements in our six projects. These studies were well conceived, professionally and independently executed and well documented. However, many of the studies we found were commissioned and completed *after* important decisions had been made, and either pointed to unsuspected problems or attempted to address problems that might have been avoided.

4.80 The Department’s operations research staff constitutes a valuable and underused resource that could be better employed to improve capital acquisition decision making.

4.81 The Department should set minimum performance standards early in the requirements definition process, based on tactical and operations research studies. Failure to achieve these standards at any subsequent phase should immediately lead to a review of the project’s viability.

Department’s response: The Department’s re–engineered acquisition approval process requires the development of a project Statement of Requirement (SOR). Supporting operational research analysis and scenario testing will play an increased role in defining these requirements. Once a project has begun, the process of matching operational requirements and the capability actually delivered continues as an iterative process through each successive phase of the project, during which project viability is assessed and, when warranted, challenged. Throughout a project, there are many opportunities for high–level scrutiny and decision making by senior departmental officials such as

the Department's Senior Review and Program Management Boards. The ongoing development of performance measurement will also serve to enhance project oversight.

Risk Management

Why risk management is important

4.82 Risk management is a systematic approach to identifying, analyzing, and controlling areas or events that have a potential for causing unwanted change. It includes planning for risks, assessing risk areas, developing options for handling risk, monitoring risks to determine how they have changed, and documenting the overall program of risk management. Through such a systematic approach to risk, its probability of occurrence and the impact of risk areas or events are assessed and reduced to an acceptable level.

4.83 Unless a comprehensive risk management process is implemented, project risks may not be adequately identified and a suitable risk-handling plan developed and implemented. The consequences of inadequate or ineffective risk management can be cost increases, schedule slippage, and products or systems that do not meet performance goals and cannot be used effectively to perform military missions.

4.84 We expected that project staffs would follow departmental and Treasury Board policies for risk management in major capital projects. Policies require a thorough understanding of all the areas of risk in the project, including scope, complexity, skills and experience of the project team, the use of new technology, and the number of organizations involved. We expected to find project risk assessments that identified and quantified the risks of projects so that strategies could be developed to control them. Since risk factors can change over the course of a project, we expected to find risk assessments performed whenever a significant project change occurred and at scheduled times during a long project.

Several projects did not follow rigorous risk management processes

4.85 We found that only one of the six projects we examined fully met our expectations for a rigorous risk management process. A comprehensive risk assessment was conducted at the outset of the Eryx missile project, using defined and specified criteria. The results of the assessment were fully documented and updated. A risk management plan was incorporated into the prime contract and updated frequently. The plan used defined and specified criteria, and linked mitigation plans and actions to risk items.

4.86 Documentation of risk management for the other five projects was either incomplete or unavailable.

4.87 For example, project management staffs for the MCDV and Leopard thermal sight projects told us that risk assessments had been conducted at the outset of the projects, but they could provide no documentation other than the summary required for the submission to Treasury Board. Documentation of initial risk assessments for the EST and Griffon projects was incomplete. Since the initial risk assessment is the key starting point for effective risk management, we believe that inadequate documentation weakens subsequent risk management.

4.88 Departmental officials told us that all project management is risk management. In their view, the risks in the projects we examined were adequately managed through ongoing project management activities such as weekly or bi-weekly meetings of the project management office; monthly progress reports from the contractor and to senior departmental management; monthly, quarterly or semi-annual project progress review meetings; regular systems engineering, integrated logistics support or other working group meetings; and other mechanisms unique to the project. The project management teams view these mechanisms as components of the risk management process.

4.89 While we agree that sensitivity to risks should be integrated into all management meetings and processes, good project management practices also require, in advance, the explicit identification, assessment and mitigation planning of problems that can be anticipated. Otherwise, project management can become no more than continually reactive crisis management. Failure to document risk assessments and mitigation activities against consistent measures also complicates internal and external communication of the status of risks and the steps taken to mitigate them.

Failure to fully assess risks reduces the effectiveness of project management

4.90 We noted instances where better risk assessment could have improved project management. Contingency allowances for the Electronic Support and Training Systems project is one example. Internal project documentation suggested that the project faced technical risks with a high probability of occurrence. When risks were reported to Treasury Board, the Department indicated that the risk of exceeding cost and schedule was a low probability, and the risk of failing to meet project performance expectations was a low to medium probability. The project was subsequently approved with a very low contingency fund, equal to only 2.7 percent of the project budget, or \$5.2 million.

4.91 If risks had been properly assessed and reported, it would have been apparent that contingency funds of 10 to 15 percent (\$19.1 million to \$28.7 million) were more appropriate, based on the Department's own guidance. Cost overruns totalling up to \$22 million on elements of the project have caused the project staff to rethink the approach to support. The original approach would probably have been manageable within the approved project funding if the contingency provision had been based on a more realistic assessment of risks.

4.92 Formal risk management might also have resulted in more timely resolution of a problem with hangars encountered by the Griffon. Project funding was approved in late 1992 on the assumption that at least one third of the aircraft would be stored outside year-round, and that the rotor blades could be folded on a regular basis. The initial risk assessment documents we examined, which were incomplete, failed to identify such assumptions and their implications. Almost immediately after project approval, the operator of the aircraft, 10 Tactical Air Group, indicated that it wanted all the helicopters to be stored inside and questioned the feasibility of folding the blades. As a result of the lack of an assessed and agreed approach to solving the storage problem, additional hangars will not be complete until February 1998, causing at least some aircraft to be stored outside for more than one year. To construct the hangars, the project infrastructure budget was increased by \$9.9 million by transferring funds from other elements of the project, although without affecting project outcomes.

4.93 Another example is "integrated logistics support". Integrated logistics support means that at the time of delivery of equipment to the field, the personnel to operate it should be trained, spares and ammunition should be available, and operator and technical publications and special tools and test equipment should already have been delivered to units. This requires complex planning and co-ordination, which, as we have reported in past audits, have proved to be a problem for the Department. Integrated logistics support is a risk area for all major capital projects, and calls for special attention.

4.94 We found that the Department had identified integrated logistics support as a risk in four of the six projects audited (MCDV, Leopard thermal sight, Eryx and Griffon). Of these, the Griffon and MCDV projects subsequently experienced difficulties in this area.

4.95 The two projects (Coyote and EST) for which the Department did not identify logistics support as a risk also experienced difficulties in this area.

4.96 The impact of delays in the delivery of logistics support can be significant. In the case of the Coyote, the delay has resulted in extending the project management office's mandate by two years, at a cost of up to \$2.6

million. The project office implemented measures to work around the difficulties. However, units have reported delays in becoming operationally ready due to shortages in support.

Projects are mostly meeting their performance and cost objectives

4.97 At the time of our audit, all six projects were expecting to meet their approved performance specifications, although some technical problems remained unresolved.

4.98 The Department expects that two projects will be completed under the Treasury Board–approved budget and the others on budget (see Exhibit 4.3).

Exhibit 4.3 is not available, see the Report

Project Cost Variance

4.99 Several projects, however, have experienced costs that might have been avoided if the projects had proceeded as planned, even though the projects remained within approved funding levels.

4.100 In the case of the Griffon project, some additional costs resulting from delays in delivery of the simulator were passed on to operational units. The simulator was delivered 17 months late, which required 403 Squadron to conduct 600 hours of training on actual helicopters. At an average operating cost of at least \$1,588 per flying hour, this incurred additional costs of \$952,800.

4.101 Delays in developing the radios for the Tactical Command Control and Communications System have meant that the Griffon and Coyote have been delivered fitted for older radios. The Griffon project spent \$2,218,000 to install old radios temporarily, while the Coyote project spent \$838,261. Additional costs will be incurred to install the new radios once they become available.

4.102 Extensions to project schedules require the expenditure of funds to maintain the project management offices for the additional time. We identified up to \$5 million in such costs for the Electronic Support and Training systems, Coyote and Eryx projects. The Electronic Support and Training systems project office has also noted that aircraft delivery slippage will result in additional costs for incremental staff and early and ongoing training of personnel, and a loss of opportunity for electronic warfare training. However, these costs have not been quantified.

Several projects experienced schedule slippages while preserving cost and performance objectives

4.103 When projects encounter difficulties, they will usually, with senior management approval, extend the schedule rather than compromise overall cost and performance objectives. Compared with the Treasury Board–approved schedule, the Department expects four projects to deliver their last major equipment component late, while one will deliver early (see Exhibit 4.4).

Exhibit 4.4 is not available, see the Report

Project Schedule Variance

4.104 In several cases, final equipment delivery dates understate delays in key project elements.

4.105 For the Electronic Support and Training systems project, the Challenger aircraft are to be delivered last, and were 22 months late at the time of our audit. Modified CT-133 aircraft and electronic warfare training pods

were forecast to be delivered before the final Challenger, but were behind the Treasury Board–approved schedule for their delivery by 23 and 34 months respectively.

4.106 Late contracting for the thermal imager, due to technical difficulties in meeting the performance specification, has delayed final deliveries on the Eryx project. The thermal imagers were originally scheduled to be delivered before the last firing posts and missiles. However, thermal imager delivery is actually 53 months later than the Treasury Board–approved schedule, and has therefore extended the overall project delivery schedule. Fielding of the system has been delayed up to 31 months due to a lack of training time available to units.

4.107 For the Coyote project, delivery of the final vehicle was forecast to be 10 months later than scheduled. However, project completion has been extended 24 months to complete the delivery of spares and maintenance manuals. These and other problems in integrated logistics support presented challenges and inconveniences as units put the vehicle into operation.

Risk management is an important part of effective project management

4.108 Many factors contribute to the successful outcome of capital projects. As the results of the Griffon project demonstrate, projects can meet or exceed their approved objectives even if their risk management processes are not explicit or well documented.

4.109 At the same time, we note the experience of the EST project, which did not use an explicit, documented risk management process. In spite of several indicators of significant technical challenge, none of the contractor’s implementation proposals was ever formally assessed for risk, even though such assessment was required by the proposal evaluation plan. The initial risk assessment had been conducted before the contractor submitted a compliant proposal, and documented only at a highly summarized level. Project documents prepared after the risk assessment noted that the project was “the most technologically ambitious modification project starting from ground zero [the Department has] undertaken to date”, but the risk assessment was not updated. Subsequently, the project experienced substantial difficulties in meeting technical performance specifications and remaining within cost, and its approved schedule has slipped significantly.

4.110 We recognize that not all difficulties can be identified in advance. Nor can identifying and mitigating risks ensure that they are entirely avoided. However, we would expect management to take a more rigorous approach to risk assessment. Mitigation and management techniques could then be focussed on the problem areas. We note that since 1993 the Department has significantly strengthened its requirements for risk assessment and management, in concert with more rigorous Treasury Board policies.

4.111 The Department should ensure the adoption of a clear and consistent risk assessment process on all major capital projects.

Department’s response: Since 1993, projects are required to include an Integrated risk management Plan and are subjected to a standard methodology and reporting system as part of the departmental risk management process. A risk analysis report is mandatory for approval of all projects over \$30 million and project staff are expected to report on a regular basis throughout the life of the project. Risk management is fundamental to effective project management and is essential to ensure successful achievement of project objectives.

Departmental risk assessments for Eryx were not consistent with the Treasury Board submission

4.112 Treasury Board must approve the acquisition phase of a project before it can proceed. This approval is based on information provided in a submission to the Board on project options, plans, cost, schedule and performance objectives, risks and management framework. At the time of approval of the six projects we examined,

Treasury Board policy required that risks reported in project submissions be based on comprehensive assessments of all known risks and their potential impact.

4.113 When we compared the documented assessments for the Eryx project with the summary risk assessments in the Treasury Board submission, we found that the submission rated overall risks as lower than had been shown in departmental risk assessment documents.

4.114 We could find no documents explaining the change in risk assessment. We noted that the Department continued to manage the project at the higher risk level once it had received Treasury Board approval.

4.115 We are concerned that inconsistent risk assessments could lead to risk management attention and resources being devoted to the wrong areas. If the level or perception of risk changes during the approval process, this needs to be documented and the revised levels reflected in subsequent assessments.

Testing and Evaluation

Why testing and evaluation are important

4.116 The primary role of a project office is to acquire equipment that can fulfil the operational tasks and missions of the Canadian Forces. It is incumbent on it to make sure that adequate tests and evaluations of equipment are carried out prior to purchase and during acquisition to confirm that the right type of equipment is being purchased.

4.117 This is especially significant where the role for which the equipment is acquired is significantly different from its intended or designed application. For example, selecting an aircraft with a commercial origin and certification as a basis for an acquisition, as was the case with the Griffon, will help to reduce developmental costs to DND and shorten the time frame for the acquisition process, which are worthwhile goals. However, this must be accompanied by efforts to ensure that the equipment will perform adequately under actual conditions. In a similar vein, the new combination of systems in a vessel based on commercial designs, as was the MCDV, can lead to unforeseen problems that will be uncovered only by operational testing under realistic conditions. The use of external agencies in the certification or acceptance testing of the base vehicle/vessel (such as the U.S. Federal Aviation Administration for the Griffon and Lloyd's Register of Ships for the MCDV) can help to ensure product quality and reduce the workload on DND staff.

4.118 Testing and evaluation are recognized as proved and effective risk management tools in major capital project acquisitions. They form a disciplined analytical activity that results in the accumulation of reliable knowledge to support risk management. This is important because it enables project managers to ascertain whether contractors are providing equipment that meets the requirements specified in the contract and that also meets the needs of the users. Limitations in the quality or completeness of testing and evaluation can obscure or delay the recognition of problems with operational suitability. Our audit found that several serious equipment deficiencies that surfaced during the use of the equipment had not been previously identified by testing and evaluation.

4.119 We expected to find that all major capital projects would have an adequate testing and evaluation plan, structured to provide essential information to decision makers, assess the attainment of technical performance goals and determine whether equipment and systems are operationally effective and suitable. If the equipment or its application are developmental in any way, or differ from the original design, we would expect the equipment to be operationally tested, ideally before it is acquired or at least before being put into active service. Recent resource cutbacks in DND, such as the shutting down of the Land Engineering Test Establishment (LETE), and heavy workloads on the existing Aircraft Engineering Test Establishment (AETE) have affected the testing and evaluation function within project management offices.

The Department could make more effective use of testing and evaluation to manage risk

4.120 We found that the weaknesses we have noted in risk management are linked to the Department's inadequate use of testing and evaluation. Unlike defence organizations in other countries, the Department does not use the function as part of an overall strategy to manage project risks.

4.121 In the United States Department of Defense, which generally undertakes projects of a more developmental nature, testing and evaluation as a risk management tool are an integral element of each phase in the acquisition life cycle. In contrast, DND's test and evaluation practices are not related to project phases or to the degree of risk associated with projects. Risk can be increased when equipment is used in ways that no other user has yet tried, when the operational envelope is extended or when even proved subsystems are combined in new ways to meet unique military or Canadian requirements.

4.122 In three of the projects we examined, the MCDV, Griffon and Coyote, operational testing was not carried out early enough to identify problems that now affect the entire fleet. As a result, each unit in the fleet will have to have its problems corrected through retrofit. As the MCDV was a purpose-built ship, testing before purchase was not feasible. However, the original contract for the MCDV allowed for a period of several months between the delivery of the first and second ships, which would have allowed for more extensive operational trials of the "first of class" vessel before follow-on vessels were built. But, because of unforeseen schedule delays, the gap between delivery of the first and second vessels was reduced. Despite the factory acceptance testing programs and sea trials in place prior to the vessel's acceptance, the Department did not discover major problems. These included the shutting down of main propulsion systems during operation (which limits the speed of the ship until it is rectified) and the malfunctioning of water purification units used to supply the ships with fresh water (which limits the range of operations possible before the supplies need to be replenished). The propulsion system problems have since been resolved under warranty.

4.123 Operational tests that could have been carried out on the Griffon to assess the aircraft's suitability for military use were not done before acquisition. As a result, the Department is now discovering that the aircraft's capabilities are being stretched to their limits, particularly when the Griffon is used in applications that push its envelope, such as search and rescue operations. Problems not yet resolved include engine overtorques, and electrostatic shocks to personnel who ground the aircraft as it hovers.

4.124 Departmental guidance documents do not clearly define the types of acquisition and the most appropriate test and evaluation practices that apply to them. In certain types of projects that are fast-tracked or sole-sourced, such as the Griffon and Coyote projects, important test and evaluation steps are often not completed until after the acquisition decision has been made and after the equipment has begun active service. For example, prior to acquisition the Department did not test the new Griffon helicopter's ability to conduct military missions. After the aircraft was introduced into service it became apparent that its capability to perform certain military tasks is limited. One of the current problems is that search and rescue personnel and other personnel can suffer severe electrical shocks if they touch the ground while suspended from or stepping out of the helicopter. Such shocks are caused by the buildup of static electricity caused by the helicopter blades. With appropriate testing, this problem could have been identified and possibly solved earlier.

4.125 The Department should re-evaluate its strategy of purchasing commercial-pattern equipment without first subjecting it to trials for its military tasks.

***Department's response:** Procurement strategies for defence acquisitions will be based on a Commercial Off-the-Shelf (COTS) or Military Off-the-Shelf (MOTS) approach where that approach satisfies the operational requirements of the Canadian Forces. The application of a COTS procurement strategy must be consistent and clear guidance on this matter is a key component of the Department's Acquisition Reform Guide. It is important to note, however, that it is not always possible to trial equipment (such as ships, for example) prior to its purchase.*

4.126 The Department should adopt a test and evaluation approach on major capital projects that ensures that:

- test and evaluation are integrated with risk management;
- comprehensive test and evaluation plans encompassing the full project acquisition life cycle are developed for each major capital project and are updated as the project proceeds;
- equipment systems and components are tested to ensure that they are technically sound, based on the completion and full reporting of all technical evaluation trials; and
- equipment performance in all respects undergoes detailed assessment against current user requirements, early enough in the process to minimize the impact that any deficiencies found may have on the acquisition.

Department's response: The importance of test and evaluation (T&E) in the acquisition process is well recognized. The Department considers that the fundamental purpose of T&E is to manage and reduce technical risk. Clearly defined and developed systems requirements (operational and technical) ensure that the correct type of system/equipment is being acquired. Prior to contract, project offices ensure that the bidders' offers will meet the statement of requirements and that the contractor's proposed T&E program is adequate.

Project Monitoring and Reporting

Why project monitoring and reporting are important

4.127 Project monitoring and reporting are important elements of project management because they provide decision makers with information on the status of the cost, schedule and technical performance of projects. This enables them to know about emerging problems and to make decisions that keep projects on budget and on schedule.

4.128 We expected to find a framework for reporting on major capital projects, as well as clear guidance to project offices on the type of project reports to be produced, their content and frequency, and project performance indicators. We also expected to find an automated set of project reporting tools to facilitate the efficient and timely preparation of project status reports.

The Department lacks an adequate framework for reporting project performance

4.129 The Department's current approach to project reporting relies heavily on project officers to decide what type of information should be reported to higher levels of management.

4.130 Except for the Maritime Coastal Defence Vessel (MCDV) project, we could not find evidence that performance indicators have been established to support project monitoring and reporting. We noted that in March 1996, the Department directed project offices to adopt the Cost Schedule and Performance Management Standard for all major capital projects. Although some of the newer projects have begun to adopt this reporting standard, of the six projects we examined only the MCDV project had done so.

4.131 Based on our audit findings, we conclude that there is a risk that senior managers in the acquisition chain of command may not regularly receive adequate project status information because there are no established standards and predefined project performance indicators that can be used as a basis for monitoring and reporting.

4.132 The Department should ensure that all major capital projects adhere to its direction to use a uniform project reporting system.

Department's response: Since 1996, all major capital projects follow a uniform cost, schedule and performance management standard. This standard was developed jointly by industry and government. This standardized reporting system is part of the broader project-reporting regime that the Department has instituted as outlined in departmental project management documents.

Conclusion

4.133 Our audit findings demonstrate that there is a need to continue the reform of the capital equipment acquisition process, particularly in the area of requirements and options analysis, risk management, test and evaluation, and project monitoring and reporting. Exhibit 4.5 summarizes our assessment of project management for the six projects we examined.

Exhibit 4.5

Overall Assessment of Project Management against Criteria

	Griffon	Maritime Coastal Defence Vessel	Eryx	Electronic Support and Training System	Coyote	Leopard Thermal Sight
Requirements Determination	2	3	2	3	3	2
Options Analysis	2	3	1	2	1	2
Risk Management	2	3	4	2	3	3
Test and Evaluation	3	3	4	*	4	*
Project Monitoring and Reporting	2	3	2	2	2	2

Legend:

- 1- Not met
- 2- Mostly not met
- 3- Mostly met
- 4- Fully met
- * Unable to assess because project has not yet reached this stage.

4.134 All six projects we examined are likely to meet their contract and cost performance objectives. Nevertheless, we are concerned about several of the management practices we observed:

- Management did not conduct adequate analyses to justify its spending decisions for most of the projects we examined, and options analyses were inadequate.
- Only one of six projects fully met our expectations for a rigorous risk management process.
- Although test and evaluation processes were satisfactory in most cases, for some of the projects involving commercially based designs the equipment was not tested under actual operating conditions until after it had been introduced into service.

- There are no established standards and predefined project performance indicators that can be used as a basis for project monitoring and reporting.

4.135 Unless the Department takes action to correct the deficiencies reported in this chapter, problems will continue to affect future capital equipment acquisitions.

***Department's comment:** The effective stewardship of resources is a primary management focus in DND. The Department continually assesses its acquisition decisions from the early analysis of requirements and options through every subsequent project phase. As well, DND is committed to continual improvement of its overall acquisition process.*

While DND welcomes the acknowledgement and encouragement of ongoing acquisition initiatives, the report does not fully portray these initiatives, or the progress made, into a broader reform roadmap which links other DND materiel management reforms and DND's contribution to multi-faceted government-wide reform initiatives. In consideration of its high cost, DND consciously decided to address operational support re-engineering first, and reform of acquisition second. We recognized that many operational support reforms would also apply to acquisition reform. Further, much work on acquisition reform was already in train. For instance, DND has already implemented reform in the approval phase of acquisition, the major cost driver in acquisition cycle times, and, similarly, in the project management portion of the acquisition process. An interdepartmental implementation plan, building on the complementary progress of DND and other departments in acquisition reform, is under way. Industry is engaged as a full partner and collectively we share many concerns that have been addressed in both DND and government-wide acquisition review.

Project risk is included in Treasury Board Submissions, which consider cost, performance, schedule and industrial benefit risk. DND also assesses additional types of risk including doctrinal, technical, and staffing risk, to name a few. Treasury Board's revised risk reporting procedure, which was introduced in 1995, better integrates this departmentally assessed risk. While risk assessment and test and evaluation are crucial to project management, not all equipment lends itself to operational testing prior to acquisition. It was not feasible, for instance, to test the coastal defence vessel (MCDV) before acquisition. However, the contractor corrected all deficiencies under warranty, which effectively achieved the same results as an enhanced test and evaluation program.

Acquisition contract decisions are based on a formal statement of military requirements and are taken in consonance with the national strategies of many governments. Project managers must ensure that the Department receives exactly what it contracts for. It is important to distinguish between the "contracted" capability and other capabilities that either were not intended for a specific weapon system or were assessed as a lesser operational priority and for which DND found an acceptable operational solution. The Auditor General's report acknowledges that this "contracted" requirement will likely be met for all six of the projects assessed. For example, the Griffon helicopter capability for which the government contracted was evident in its UN peacekeeping deployment to Haiti and the support provided to domestic disaster relief operations.

With respect to performance reporting, DND does not share the auditors' conclusion that this is left to the discretion of individual project managers. Senior management is fully informed of project status through various project management mechanisms including monthly progress reports from contractors, formal Design Review meetings and regular updates to senior departmental Boards.

About the Audit

Objectives

The objective of this audit was to determine whether individual major capital projects were managed adequately, with particular emphasis on the following areas:

- requirements and options analysis;
- risk management;
- test and evaluation;
- project management, monitoring and control; and
- implementation of best practices in project management.

Scope

Our audit focussed on two management levels: the project office level, which manages individual major capital projects, and the base or unit level where operators use the equipment to carry out military tasks and operations.

We selected six major Crown projects (MCPs) out of a total 24 active MCPs (over \$100 million value). Our sample was selected on the basis of judgment and included projects from each of the three environments — navy, army and air force. The total value of the MCPs we reviewed is \$3.3 billion. Our criteria in selecting these projects were to obtain a tri-service sample with cumulative project expenditures of 80 percent or less that were typical of the kind of major equipment currently being acquired by DND. We selected the following projects: the Utility Tactical Transport Helicopter (Griffon), the Electronic Support and Training System, the Light Armoured Reconnaissance Vehicle (Coyote), the Short Range Anti-Armour Weapon (Heavy) (Eryx missile), Leopard Thermal Sight, and the Maritime Coastal Defence Vessel (MCDV). We recognize that these six projects may not be statistically representative of all DND major capital equipment projects. Their total value of \$3.3 billion, representing about 14 percent of the total value of approved capital projects over \$100 million in the Department's 1996-97 long-term equipment capital plan, makes them significant in their own right. The conclusions from this audit should be of interest to departmental officials involved in other major capital equipment projects.

For each of the six projects noted, we contacted the project office and discussed relevant acquisition issues. We obtained and reviewed available documentation pertaining to requirements and options analysis, risk management, test and evaluation, and project management and reporting. Finally, we conducted field visits and met with equipment users and operators to determine if the equipment met their operational needs.

We also met with foreign officials in the United States and with representatives of Canadian industry.

We used a results-based audit approach, with the primary focus on whether the Department exercised due diligence in the selection, acquisition and testing of equipment prior to putting it into operation and whether the operators of the equipment could adequately perform the tasks and missions for which it was acquired. In brief, we assessed whether DND's capital acquisition process delivers the type of equipment needed by the armed forces when they need it and at the best value for money.

Criteria

In assessing the MCP process, we used the audit criteria contained in the Office of the Auditor General's guide, *Auditing Capital Asset Projects*, as well as National Defence's publication, *Defence Program Management System (CFP-125)*. We also performed comparisons of National Defence's MCP process with capital procurement practices of other military organizations, such as the US Department of Defense and the UK Ministry of Defence. The detailed criteria we used are described in each section of the report, along with audit findings.

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Chapter 5

Revenue Canada, Department of Finance and Department of Justice

Interdepartmental Administration of the Income Tax System

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Revenue Canada, Department of Finance and Department of Justice

Interdepartmental Administration of the Income Tax System

Main Points

5.1 Three departments play a key role in administering the income tax system. The Department of Finance is responsible for the formulation of tax policy and the introduction of new tax legislation, Revenue Canada oversees the administration of tax laws and the Department of Justice provides legal advisory services and litigation services to both Finance and Revenue Canada.

5.2 Efficient and effective relationships among Revenue Canada, the Department of Justice and the Department of Finance are essential for the smooth functioning of the income tax system. This audit was undertaken because our past work had raised some concerns about the management of risk to the tax base. Our current examination found that the departments have taken many important measures to improve their relationships. We have been told that the proposed change of Revenue Canada to a new Canada Customs and Revenue Agency will not affect their relationships.

5.3 An important aspect of managing the risk to the tax base is the identification and correction of legislative deficiencies. We found that Revenue Canada and the Department of Justice regularly bring deficiencies to the attention of the Department of Finance. However, the correction of legislative deficiencies is left to the discretion of the Department of Finance.

5.4 As all three departments are key players in managing the risks arising from legislative deficiencies, it is important that they all be involved in deciding which deficiency should be given priority.

5.5 The management of tax litigation risks has been improved. However, Revenue Canada and the Department of Justice need to strengthen the partnership arrangement for planning litigation needs and managing the risks.

5.6 Settlements of income tax disputes resolved through consent judgments have been made on a mix of law and facts. Revenue Canada should provide transparency in the settlement agreements it undertakes. As an example, United States income tax law provides public access to settlement agreements, with privacy protection of the taxpayer's identity.

Introduction

Relationships among Revenue Canada, the Department of Justice and the Department of Finance in administering the income tax system

5.7 Roles of each department. Three departments play a key role in administering the income tax system. The Department of Finance (Finance) is responsible for the formulation of tax policy and the introduction of new tax legislation, Revenue Canada oversees the administration of tax laws and the Department of Justice (Justice) provides legal advisory services and litigation services to both Revenue Canada and Finance.

5.8 More specifically, the Department of Finance is responsible for undertaking analysis and providing policy advice on taxation matters at the federal level. It is also responsible for maintaining a tax system that raises revenue in a fair and efficient fashion and effectively targets incentives to meet government goals. In addition, Finance develops legislation and regulations necessary to implement federal tax measures, and it seeks to develop tax policies consistent with the government's objectives in other areas — social, cultural, economic, political, regional and federal–provincial.

5.9 Revenue Canada is responsible for operational and administrative policy related to the application of the tax legislation and for technical interpretations of the law. It collects a variety of taxes: income tax, goods and services tax, commodity taxes, excise duties and other levies.

5.10 This audit was undertaken because our past work had raised some concerns about the management of risk to the tax base. In our May 1996 chapter on income tax avoidance, we reported instances where legislative deficiencies were corrected promptly, while at the same time there were instances of slow action. Our 1993 audit observation on the resource allowance income tax provisions pointed out poor risk assessment practices related to tax issues in dispute. In addition, parliamentarians have expressed a great deal of interest in the relationships among the departments and the process for identifying and dealing with deficiencies in tax law and managing the risk to the tax base.

5.11 Operational linkages. Exhibit 5.1 shows key operational linkages among the three departments. They interact in many ways — from finding the appropriate treatment of specific tax cases to updating tax legislation and administrative practices.

Exhibit 5.1 is not available, see the Report

Operational Linkages among Revenue Canada, Department of Finance and Department of Justice

5.12 Revenue Canada is uniquely positioned to attest to the difficulties related to the administration of the *Income Tax Act* by virtue of its access to extensive data as well as through its interaction with 25 million Canadian businesses and individual taxpayers. It brings to the attention of the Department of Finance problems it detects in applying tax legislation. It also provides input to Finance on the administrative consequences of proposed legislative changes.

5.13 Revenue Canada and the Department of Justice interact through tax cases that require a legal opinion, through cases appealed to the Tax Court of Canada, the Federal Court of Appeal or the Supreme Court of Canada, through settlement proposals and through discussions about adverse court decisions.

5.14 It is important for the Department of Finance, Revenue Canada and the Department of Justice to communicate effectively. Systems need to be in place to permit Finance to learn about problems with the tax system

as quickly as possible. It is also important for Revenue Canada and Justice to have an opportunity to comment on the compliance and administrative aspects of legislative proposals. This should ensure that legislative drafters take into account the compliance and administrative aspects of the proposals.

5.15 The Policy and Legislation Branch of Revenue Canada acts as the focal point for co-ordination of Revenue Canada's input into the legislative agenda and as the liaison function with the Tax Policy Branch of Finance. The liaison function includes the participation in the development of tax policy and its impact on tax administration and the drafting of proposed amendments. The Tax Law Services Branch of Justice liaises with the Tax Counsel Division of Finance.

5.16 Interdepartmental committees provide a forum to facilitate the exchange of information and views on the application of tax legislation and the administration of the tax system. These interdepartmental committees include the Risk Management Committee, the General Anti-Avoidance Rule (GAAR) Committee, the Scientific Research and Experimental Development (SR&ED) Committee and regular monthly meetings of assistant deputy ministers from each department. The drafting of technical amendments is done by the Legislative Review Committee, which is chaired by an official of the Tax Legislation Division of the Department of Finance. This committee includes officials from all three departments.

5.17 **New Canada Customs and Revenue Agency.** In the 1996 Budget, the government announced the proposed creation of a new Canada Customs and Revenue Agency. It is expected that legislation creating this agency will be tabled early in the 1998-99 fiscal year. The new agency will remain a part of the Public Service of Canada and will have more flexibility in exercising administrative duties. It is our understanding that there is no intention to change the existing relationships of the three departments.

Focus of the audit

5.18 This audit focussed on the processes in place to bring problems with the administration of the income tax system to the attention of the Department of Finance in order to correct legislative deficiencies. It also focussed on the interdepartmental risk management processes in place to deal with the risks associated with income tax litigation. Further details on the audit are in **About the Audit** at the end of the chapter.

Observations and Recommendations

Managing the Risks Arising from Legislative Deficiencies

Tax issues are brought to the attention of the Department of Finance through a variety of channels

5.19 **Revenue Canada.** In 1995-96 and 1996-97, Revenue Canada brought about 200 tax issues to the attention of the Department of Finance. These issues originated mainly from the advance income tax ruling and audit processes. About 80 percent of them required Finance's views on whether specific transactions fell within the intent of tax policy, in order to issue advance income tax rulings and reassessments. The other 20 percent provided Finance with a specific recommendation to consider a legislative amendment.

5.20 Revenue Canada is also involved in the Budget process. For the 1997 Budget, it submitted seven proposals to change the tax legislation. Some of the Budget proposals related to areas where, in the past, Revenue Canada and Finance had agreed that amendments were needed.

5.21 To further the identification of problems in applying the tax legislation, rulings officers and experienced auditors develop issue papers that review recent advance income tax rulings issued in connection with certain types of transactions or recent assessments. These papers often identify potential legislative changes.

5.22 We examined the processes followed by Revenue Canada in developing these proposals and in determining whether a change in the legislation was needed. We found that Revenue Canada had implemented processes to strengthen its policy and legislation function.

5.23 Revenue Canada branches set up review mechanisms to analyze deficiencies brought to their attention by field auditors and appeals officers. The branches consider various corrective measures such as a change in the Department's assessing position, additional enforcement or a legislative change.

5.24 The Verification, Enforcement and Compliance Research Branch established a Legislation Unit to analyze the significance of legislative deficiencies detected by field auditors, to conduct research on the issues involved and to develop legislative proposals.

5.25 The Policy and Legislation Technical Sub-Committee reviews significant technical issues and other matters. It includes the Assistant Deputy Ministers of Verification, Enforcement and Compliance Research; Assessment and Collections; and Policy and Legislation as well as the Senior General Counsel. The sub-committee recommends, among other things, which adverse court decisions should be appealed and if legislative amendments should be sought. The Appeals Branch has assigned an appeals officer to monitor legislative deficiencies identified in reviewing notices of objection and adverse court decisions.

5.26 The Department's various branches refer their legislative proposals to the Policy and Legislation Branch to ensure that the need to amend the legislation is further considered by senior officials of Revenue Canada. In order to bring the necessary rigor to legislative proposals received from individual program branches and to ensure that these proposals are thoroughly researched and take into consideration all corporate concerns, Revenue Canada established a committee in 1996 called the Policy and Legislation Committee. The mandate of this committee is to review significant legislative proposals put forward by Revenue Canada, horizontal program policy issues emanating from within Revenue Canada, major program policy issues led by a Revenue Canada branch, and policy issues originating in other government departments.

5.27 We examined how these new mechanisms interacted and whether there had been any improvements since their implementation. We found that better documented and researched legislative proposals had been submitted to the Department of Finance.

5.28 Department of Justice. The Department of Justice has recently strengthened its mechanism to develop legislative proposals for consideration by the Department of Finance. It now includes specific legislative proposals in its reporting letter to Revenue Canada on adverse decisions of the courts.

5.29 Interdepartmental committees. The Department of Finance is involved in the tax administration process through its participation in interdepartmental committees. Finance officials are involved in dealing with specific tax avoidance transactions and in the application of the General Anti-Avoidance Rule through their participation in the GAAR Committee. On a weekly basis, this committee reviews tax avoidance schemes detected by Revenue Canada field auditors and advance income tax rulings officers. Finance also participates in the Scientific Research and Experimental Development Committee.

5.30 Finance officials participate in a three-department Risk Management Committee. On a quarterly basis, this committee reviews the status of cases involving important litigation risks.

5.31 Issues may also be brought to the attention of senior officials of each department. Every month or so, assistant deputy ministers meet to review and discuss issues of common interest to their organization. Issues discussed include tax policy, administrative matters and compliance burden concerns.

5.32 Informal contacts. There are numerous other ongoing meetings and informal contacts between officials of the three departments. These are important to the smooth functioning of the tax system. For example, the Tax Law Services Branch of the Department of Justice holds bi-weekly meetings with representatives from the tax counsel division of Finance, Revenue Canada Legal Services and Justice Tax Litigation Services. These meetings facilitate the identification and communication of legislative deficiencies to the Department of Finance through the tax counsel division.

Finance responds to Revenue Canada’s requests for tax advice in a timely manner

5.33 We examined the responses provided by the Department of Finance to Revenue Canada’s requests for tax advice and legislative change.

5.34 In general, we found that the Department of Finance provided a response to Revenue Canada’s requests for tax advice within a two-to-four week period. This allowed Revenue Canada to issue advance income tax rulings and reassessments.

Senior officials of all three departments need to be involved in the decision to correct legislative deficiencies

5.35 With respect to requests to amend the legislation, the record is not as clear. We have observed many instances where the Department of Finance moved quickly to introduce legislative changes in response to Revenue Canada’s recommendation. These instances presented significant risks to the tax base — tax shelters, joint exploration corporations, and stop-loss rules (see Exhibit 5.2).

Exhibit 5.2

Reporting and Correction of Legislative Deficiencies Related to Tax Shelters

1993	Revenue Canada identifies 26 legislative and administrative deficiencies from tax shelter study.
January 1994	Revenue Canada communicates 10 legislative proposals to Finance.
February 1994	1994 Budget announces two legislative changes to restrict the use of abusive tax shelters.
December 1994	Finance and Revenue Canada announce further measures to restrict abusive tax shelters.
February 1995	1995 Budget replaces film tax shelter mechanism for certified Canadian films with a tax credit.
March 1996	1996 Budget announces measures to restrict abusive tax shelters based on seismic data.
November 1996	A Notice of Ways and Means Motion proposes measures to further constrain tax shelters relying on a mismatch of income and expenses.
July 1997	Finance and Revenue Canada announce that tax shelters used to finance non-Canadian films will be replaced with a tax credit.
August 1997	Finance releases draft legislation intended to prevent abuses in computer software tax shelter property rules.

Finance acted promptly to correct legislative deficiencies brought to its attention by Revenue Canada. Legislation implementing announced corrective measures had not been enacted as of February 1998.

5.36 We have noted other situations where Revenue Canada reported regularly to the Department of Finance the difficulties it was having in administering certain provisions of the *Income Tax Act*, and Finance was slow to act. For example, Revenue Canada reported as early as 1988 instances of abuse of income tax provisions dealing with charitable donations. Changes in this area were announced in the 1997 Budget, nine years later.

5.37 Proposed changes are inventoried until a decision is made to proceed with an amendment. We noted that many proposed legislative changes had been in Finance's inventory for a number of years. For example, the inventory at June 1997 included over 400 items. About 67 percent of those items were more than four years old and were added to the inventory between 1986 and 1993.

5.38 The major reason given for the large number of outstanding requests for amendments was the overburdened legislative agenda of the last Parliament. Ideally, Finance would like to introduce a technical amendment bill annually. The last one was introduced in April 1995. The 1995 technical bill, most of the 1997 Budget measures and many other changes introduced since 1995 had not been enacted as of March 1998. Finance officials were unwilling to consider commencing work on another technical bill until after the current draft legislation was enacted. They were also concerned about taxpayers' ability to absorb a large volume of changes in a relatively short period of time. They indicated to us that there was pressure from tax practitioners to not add to the current volume of outstanding draft legislation. As a result, there had been no review of the inventory since November 1994.

5.39 The decision to introduce legislative amendments before Parliament depends on many factors, such as the need to consider other policy issues, the legislative agenda, the need to consult with stakeholders and priorities dictated by a Budget. However, Finance can stop tax leakage caused by a legislative deficiency by announcing its intention to amend the law through a Budget, a press release, or draft legislation.

5.40 Unresolved legislative deficiencies can pose significant risks to the tax base. However, the correction of legislative deficiencies and the time frame in which they are corrected is left to the discretion of the Department of Finance. As all three departments are key players in managing the risks arising from legislative deficiencies, it is important that they all be involved in deciding which issues should be given priority. This could be done through the interdepartmental committee of assistant deputy ministers.

5.41 The Department of Finance should regularly seek advice from the interdepartmental committee of assistant deputy ministers on which deficiencies should be given priority for correction.

Department of Finance's response: The Department is in general agreement with the conclusion that continued co-operation between the departments of Finance and Justice and Revenue Canada is essential to the smooth administration of the tax system. The officials of the Tax Policy Branch are committed to this goal.

Managing the Risks Resulting from the Dispute Resolution Process

Over 50,000 notices of objection are filed each year

5.42 Each year, taxpayers file 50,000 to 55,000 notices of objection with Revenue Canada. The objection process allows the taxpayer to submit additional information and the Department to reconsider its original assessing position.

5.43 Currently, 550 employees assigned to the Appeals Branch of Revenue Canada in each of 37 Tax Services Offices (TSOs) and Taxation Centres do the review of these objections. In 1996-97, 29,000 objections were handled in the TSOs and 24,000 in the Taxation Centres.

5.44 Objections come from various Revenue Canada compliance programs. In 1996-97, there were 12,000 from field audit and 14,000 from the initial assessment process. The total value of taxes in dispute in these objections was reported by Revenue Canada to be over \$2 billion in that year.

5.45 Information provided by Revenue Canada shows that the outcome of the review of the objections in 1996-97 was as follows: taxes objected to confirmed – 34 percent; allowed in part – 19 percent; allowed in full – 27 percent. An additional 20 percent of objections were considered to be invalid or raised other concerns such as a request for a fairness review. Overall, Revenue Canada reported that 58 percent of the tax in dispute was retained after the objection stage (see Exhibit 5.3).

Exhibit 5.3 is not available, see the Report

Outcome of the Dispute Resolution Process, 1996-97 - Revenue Canada

5.46 Following the completion of the objection stage, about 4,000 tax disputes proceed to the Tax Court or Litigation stage. Revenue Canada designated appeals officers and Justice tax litigators, located in several cities across Canada, handle tax litigation cases in the Tax Court of Canada. The Tax Court cases follow one of two procedures — Informal Procedure for cases where taxes in dispute are \$12,000 or under per year and General Procedure for cases where taxes in dispute are above \$12,000.

5.47 How each case proceeds and is ultimately disposed of varies between the two procedures of the Tax Court. In 1996-97, in the Informal Procedure, 31 percent of the cases were withdrawn by the taxpayer or dismissed, 20 percent resulted in consent judgments, and 49 percent proceeded to trial. In the General Procedure, 44 percent were withdrawn or dismissed, 27 percent resulted in consent judgments and 29 percent proceeded to trial. Taxpayers were successful at trial, in whole or in part, about 30 percent of the time in the Informal Procedure and 33 percent of the time in the General Procedure. In total, there were about 1,300 Informal Procedure judgments and 400 General Procedure judgments resulting from trials (see Exhibit 5.4).

Exhibit 5.4 is not available, see the Report

Outcome of the Dispute Resolution Process, 1996-97 - Tax Court of Canada

5.48 Following the judgment of the Tax Court, about 200 appeals are launched in the Federal Court of Appeal. Most of these are appeals from General Procedure decisions. Approximately 20 percent of Federal Court appeals are initiated by the Crown and 80 percent by the taxpayer.

5.49 Last year, the Federal Court disposed of 99 tax appeals by way of judgments. Revenue Canada was successful in 20 of the 31 appeals it initiated. Taxpayers were successful in 8 of the 66 appeals they initiated. There were two consent judgments. Another 33 cases were discontinued, 12 of these by the Crown. Finally, leave to appeal may be sought from the Supreme Court of Canada, and the Court hears a small number of tax cases (about three to five) each year.

A risk management process is in place

5.50 As outlined in the government's response to the Seventh Report of the Public Accounts Committee in September 1995, Revenue Canada, Justice and Finance have adopted a strategy for the management of risk to the tax base resulting from the dispute resolution process.

5.51 The Assistant Director of Appeals at each Tax Services Office reviews the notices of objection and most of them are handled at the TSO. Some high-profile objections are instead dealt with at Headquarters. These include some income tax avoidance and large file audit appeals. Other cases require a review by Headquarters when an appeals officer proposes to revise an audit reassessment — for example where the audit has included a legal opinion.

5.52 “Important issues list” created. As part of the risk management process, an “important issues list” has been created and is updated each quarter. The list indicates which cases are priority litigation cases, and which are test cases that represent issues concerning many other taxpayers. The following four reasons account for the importance of a case — quantum, tax policy, tax administration or social policy. The list also indicates the amount of tax at risk in these cases and the immediate cash impact of an outcome adverse to Revenue Canada. Currently, the list includes over 100 cases with a total estimated tax impact of over \$4 billion. The identification and communication of important issues alert the system to the risks involved and provide national consistency in the treatment of the issues.

5.53 Our audit confirmed that this risk management activity at the objection stage is being carried out as described in the 1995 strategy.

5.54 Risk management depends on reliable estimates of taxes in disputes. An important criterion for the assessment of risk at all steps in the dispute resolution process is the quantum of tax and interest at risk. This estimate is made for each notice of objection and is utilized in various aspects of the risk management process. Assistant directors of appeals have informed us that one weakness in the risk assessment strategy is the lack of a clear understanding of how tax at risk should be determined and recorded by appeals officers.

5.55 Revenue Canada should provide better support to enable appeals officers to better estimate taxes in dispute at the objection stage.

Revenue Canada’s response: The Appeals Branch remains fully committed to providing support to its appeals officers to enable them to estimate taxes in dispute at the objection stage. On 9 March 1998, a directive was issued to all appeals officers in Headquarters and the field on risk management and the information required to update the important issues list, which, among other things, indicates the amount of tax at risk in priority litigation cases (i.e. taxes in dispute). Included in the directive were guidelines for calculating the amounts of taxes in dispute and the interest at risk. In addition, co-ordinators from Headquarters have been identified to provide advice and assistance to appeals officers with the identification and compilation of risk management information pertaining to taxes in dispute. This assistance includes advice on calculating tax and interest amounts at risk. In addition, follow-up training for all appeals officers will be provided in this area during the upcoming fiscal year.

The Current Settlement Process

Settlements require documentation

5.56 At the Tax Court stage, the steps followed by Revenue Canada and Justice in handling litigation vary between the two procedures of the Court. However, in both cases, the appeal notices from taxpayers are all forwarded by the Tax Court to Revenue Canada Headquarters and are then assigned to a designated appeals officer in Headquarters or one of the Tax Service Offices. In the Informal Procedure cases, the Revenue Canada appeals officers draft the Notice of Reply to the appeal and file it with the Tax Court before handing the file over to Justice. In the General Procedure cases, the files are forwarded immediately from Revenue Canada to Justice and Justice lawyers draft the replies.

5.57 Our review of the files shows that Revenue Canada is involved in discussing and approving the litigation approach and settlement offers made and received by Justice at both the TSO and Headquarters levels. Our review also shows that the Revenue Canada designated appeals officers complete a consent judgment report on each settlement after it has been signed by a Tax Court judge. However, often Justice prepares no written reasons for the settlements in the Informal Procedure cases when it proposes a settlement to Revenue Canada. As settlements can result in significant tax changes, they all should be supported by proper documentation from Justice tax litigators.

5.58 The Department of Justice should complete a reporting letter for all consent judgments it recommends.

Department of Justice's response: As referred to below, Revenue and Justice have updated a Settlement Protocol that specifies the autonomy that Justice has in agreeing to out-of-court settlements. It was agreed between both departments that it would be more efficient in "Court House Step" situations for Justice to be able either to reach a settlement without consulting Revenue or to reach a settlement after consulting with Revenue by telephone. It was also agreed with Revenue, taking into account resources constraints, that a reporting letter would not be required in respect of common issue informal procedure matters. However, taking into account your recommendation, we will alter our procedure to provide a brief reporting letter in the above-noted circumstances.

5.59 Recently, a Settlement Protocol was updated between Revenue Canada and Justice, which specifies the autonomy that Justice has in agreeing to settlements in both divisions of the Tax Court. As well, a Tax Law Services Litigation Strategy was introduced, which will identify and monitor risk at the litigation stage and will formally review General Procedure cases for the possibility of settlement at a number of stages in the litigation process.

5.60 Consent judgments are reached in 34 percent of the appeals that proceed in the Tax Court. This follows the objection stage where Revenue Canada reports that 63 percent of the cases have been settled. The principal reason given for settlement of additional cases at the litigation stage, especially with Informal Procedure cases, was new information provided by the taxpayer. Our review of consent files indicates this was the case. We observed that often information from taxpayers that would have been important to accurately complete the audit was not presented by the taxpayer until late in the litigation stage and then it resulted in a settlement being reached.

5.61 Each step in the dispute resolution process involves additional time and effort from Revenue Canada and Justice. Since Revenue Canada has committed to resolve disputes earlier, the timely receipt of taxpayer information is critical. Two recent examples of initiatives that encourage early resolution of tax disputes with corporate taxpayers are Section 231.6 of the *Income Tax Act*, which requires the early disclosure of foreign-based information, and the requirement that large corporate taxpayers pay one half the taxes in dispute and specify the reasons for their objection when filing an objection. Other non-legislative initiatives could be considered.

5.62 To facilitate earlier settlements, Revenue Canada should consider developing a broader strategy to promote the earlier disclosure of information by all taxpayers.

Revenue Canada's response: To reaffirm the role of the Appeals Branch in providing fair, timely and impartial dispute resolution, the Appeals Renewal Initiative was announced on 17 April 1997. One of the identified goals was the improved facilitation of communication between taxpayers and Revenue Canada. To that end, all relevant documents are now being made available to taxpayers and local access to government lawyers is being provided. A communication strategy is also being developed to encourage all taxpayers who file objections to provide the Department with full and complete details of their case. Additional communications training is being provided to appeals officers.

5.63 Our review of the consent judgment files, and discussions with Justice litigators, indicates that settlements have been made on a mix of law and facts. Our review also indicates that the documents that structure settlement agreements may take various forms such as Minutes of Settlement or letters from Justice Tax Law Services to Revenue Canada officials and do not form part of the consent judgment. United States tax law provides public access to settlement agreements, with privacy protection of the taxpayer's identity.

5.64 Revenue Canada should provide transparency in the settlements it undertakes.

Revenue Canada's response: In fiscal year 1997, over 90 percent of the settlements that were reached between taxpayers and Revenue Canada at the Tax Court level were pursuant to a consent judgment. When settlements are

reached between taxpayers and Revenue Canada at the Tax Court level, pursuant to a consent judgment, documents are filed in Court outlining the settlement. A Tax Court judgment incorporating the terms of the consent is then issued after approval by the Court. Both the Tax Court judgment and the underlying consent documents are accessible to the public.

Administering Income Tax Litigation

Justice Tax Law Services needs to move into the electronic age

5.65 Tax Law Services of Justice is comprised of Tax Litigation Services and Legal Services. Tax Litigation Services does not have electronic access to the electronic database of legal opinions of the Justice Legal Services group located at Revenue Canada Headquarters. Although such electronic access has been discussed for several years, and would facilitate consistency in the litigation approach, it does not yet exist. Electronic access to these opinions by litigation lawyers would improve the integration of the legal advisory services and litigation services in Justice Tax Law Services. As well, access to these opinions and to Revenue Canada's Legislative Information Database could improve the efficiency of litigation preparation in Justice, as could the electronic transfer of documents between Justice and Revenue Canada.

5.66 The Department of Justice should develop the ability to electronically access legal opinions and other Revenue Canada interpretive information and transfer documents between it and Revenue Canada.

Department of Justice's response: Since 1991, Justice has maintained a Tax Litigation System (TLS) that has recorded "tombstone data" with respect to all income tax appeals (except regional informal procedure appeals), including the assigned Justice office, the section of the statute and a description of the issues involved. For the last few months, Revenue Canada and Justice have been working toward the development of a secure Extranet site where fiscal information would be made available both to Revenue and to Justice lawyers of the Tax Law Services Branch. One of the key elements of the Extranet would be to provide access to the legal opinions of our Legal Services Unit. We are also looking at a way of providing a secure communication link either via this Extranet site or by the use of a software such as Entrust. Two joint working groups — one devoted to technological needs and the other to business needs — are leading the projects.

Better information on the use of litigation resources is needed

5.67 There are about 120 lawyers and 70 other support persons currently involved in tax litigation work in Justice across Canada. Until recently, Justice Tax Litigation Services was not able to routinely account for the time required to complete individual cases or effectively track their progress.

5.68 A new computerized case management and resource-tracking system has been developed by Tax Law Services. It will track the progress of a case, from the Tax Court to the Federal Court and onward, and the resources devoted to it. The implementation of a new electronic system is critical to the efficient and effective management of the litigation process and provision of resource management information but it has been proceeding slowly over the past year.

5.69 The Department of Justice should implement a computerized case management and resource-tracking system in all tax litigation offices in a timely manner.

Department of Justice's response: The Department of Justice is committed to the implementation of Caseview and Timewave in all tax litigation offices. In August 1997, the Group Head of the Edmonton Tax Litigation Section was dedicated to lead and complete this project in a timely manner.

5.70 Until recently, forecasting demands for litigation and other services provided by Justice Tax Litigation Services and communicating these to Justice has not been well handled by Revenue Canada. As described above, Justice has been unable to accurately report to Revenue on the use of resources assigned to litigation.

5.71 However, in the past year, Justice Tax Litigation Services has undertaken an in-depth review of its resources, and has been working with Revenue Canada to better identify Revenue's legal needs and meet those needs. For example, as part of the implementation of the Appeals Renewal Initiative, Revenue Canada has requested that Justice Tax Litigation Services provide legal assistance to the appeals officers who are handling objections in the Tax Services Offices. As of November 1997, the Department of Justice began providing legal advice to all appeals divisions. Seven additional lawyers have been placed in the regional Justice offices and Legal Services in Ottawa for this task. Revenue Canada is paying for the salaries. As well, Justice Tax Law Services has established national co-ordination teams, which include Revenue Canada, for particular tax litigation areas such as tax avoidance.

5.72 More could be done to foster a spirit of joint accountability for handling tax litigation and planning for litigation resources. To better forecast Justice workload and resource requirements regionally and nationally, it is important that Revenue Canada's regional and headquarters assistant deputy ministers recognize the demand for services provided by litigation lawyers in all aspects of *Income Tax Act* administration. Additionally, Tax Law Services must develop the capacity to fully participate in this joint planning and management process.

5.73 The partnership in planning litigation needs and managing the risks of litigation should be strengthened between the Appeals Branch of Revenue Canada and Justice Tax Law Services.

Revenue Canada's response: Significant steps have already been taken by the Appeals Branch of Revenue Canada and Justice to better plan and manage the risks of litigation. A joint conference was held in October of 1997 to forecast litigation needs and issues, and to plan joint training. A pilot project has been undertaken with respect to GST cases to develop a common reporting and tracking system. A joint session was held on 23 March 1998, to explore and assess the use of common information and technology. Bi-weekly meetings are now being held between the Assistant Deputy Attorney General for Tax Law Services and the Assistant Deputy Minister, Appeals Branch, to discuss litigation needs and issues of mutual concern.

Department of Justice's response: In addition to the comments made by Revenue Canada, we add that as part of the Early Case Management program that was developed by Justice (September 1997) in consultation with Revenue, meetings of Justice Group Heads and Revenue managers are scheduled in the departments' head offices and regional offices as needed to review issues arising in litigation files including settlement. These meetings focus on cases of importance, in particular those where Justice and Revenue have not been able to arrive at a consensus.

Process for appeals to the Federal Court of Appeal needs to be more timely

5.74 Federal Court of Appeal cases are handled by Revenue Canada from its Headquarters Appeals operations in Ottawa. The Justice lawyers handling the cases are located in eight regional Justice offices.

5.75 As part of the risk management strategy, the decision to pursue an appeal to the Federal Court involves the three departments. After an adverse decision in the Tax Court, the lawyer who handled the litigation carries out a review of the reasons for the decision and, when desirable, a recommendation to appeal is made. When the case is on the "important issue list", the recommendation is forwarded to the Portfolio Litigation Co-ordinator in Ottawa. The Justice recommendation is then forwarded to the Assistant Deputy Minister of Revenue Canada, Appeals Branch, with a copy going to the Tax Counsel Division at Finance.

5.76 The Revenue Canada designated appeals officer responsible for the case also prepares an adverse decision report, which is reviewed by Revenue Canada Headquarters if an appeal is recommended. Officials from Justice and

the Appeals Branch of Revenue Canada meet bi-weekly to review some of the more difficult cases. They may also seek the views of Finance. Last year, Revenue Canada Appeals Branch recommended 36 appeals to the Federal Court; 24 of these cases proceeded. Our review of files indicates that up to this point the process of reviewing adverse decisions was being completed in a timely manner.

5.77 The Crown's appeal to the Federal Court is filed within the required 30 days of the Tax Court judgment. The final decision to proceed with the appeal is taken by the Policy and Legislation Technical Sub-Committee of Revenue Canada. We noted that the Assistant Deputy Attorney General for Tax Law Services does not attend these meetings.

5.78 The six months or so that pass between the initiation of an appeal and this confirmation introduce a significant delay. This delay may cause a conflict with the new Federal Court rules that are aimed at speeding up the court process. The Policy and Legislation Technical Sub-Committee approves over 90 percent of the appeals recommended to it.

5.79 This adverse decision process also makes recommendations to Finance when an appeal should be accompanied or replaced by a legislative amendment. In the past year, Justice has recommended amendments to Finance on five occasions in an adverse decision report. The Technical Sub-Committee of Revenue Canada has recommended a legislative amendment on 10 occasions in considering a decision to appeal.

5.80 Revenue Canada's Policy and Legislation Technical Sub-Committee should act to confirm the Federal Court of Appeal cases in a timelier manner.

Revenue Canada's response: Revenue Canada realizes that with the advent of the new Federal Court Rules, the timely consideration of adverse decisions is increasingly important. To improve the process, the Sub-Committee is now scheduled to meet every four weeks and instructions have been issued to all parties relevant to the decision-making process to provide analysis and recommendations in a timely matter. Together, these measures will ensure that recommendations to appeal to the Federal Court of Appeal are dealt with expeditiously.

Risk Management and the Appeals Renewal Initiative

Internal document advises to proceed with caution

5.81 In its response to the Public Accounts Committee in September 1995, the government stated that "more than 96 percent of the formal objections made by taxpayers are resolved by negotiation before they reach the stage of judicial hearing." The government also pointed out, "the Courts have made it clear that the settlement of fiscal disputes must be in accordance with the *Income tax Act* and may not be pure compromise that ignores the law."

5.82 Revenue Canada announced its Appeals Renewal Initiative (ARI) in April 1997. The principal objectives of the ARI are to facilitate earlier resolution of taxpayer disputes, to improve communication between taxpayers and Revenue Canada, and to improve transparency to the taxpayer by providing documents earlier that outline the Department's audit position. The Department has introduced a series of measures to implement the initiative.

5.83 An important aspect of the ARI was a commitment by Revenue Canada to consider ways to increase the timeliness and number of settlements.

5.84 In January 1998, Revenue Canada prepared a paper on Alternative Dispute Resolution (ADR) outlining possible ADR techniques (mediation, negotiation and arbitration) that could be used at the objections stage. This paper also contemplates amending the *Income Tax Act* to permit the Minister of National Revenue to make

compromise settlements at the objections stage. As a next step, the Revenue Canada paper is to be discussed with Justice and Finance, and possible pilot testing of mediation has been recommended.

5.85 The paper includes several cautions for the proposed use of Alternative Dispute Resolution, including the possibility of disturbing a relatively well-functioning appeals system. We agree with these cautions. As well, a recent General Accounting Office report on the US Internal Revenue Service experience with the use of the ADR technique of mediation has indicated a relatively low uptake of this technique by taxpayers and a concern with the additional time consumed by the process.

5.86 In exploring the use of Alternative Dispute Resolution techniques, Revenue Canada should proceed slowly, with transparency and with appropriate risk assessment criteria.

Revenue Canada's response: Revenue Canada, together with the departments of Justice and Finance, has been examining the present constraints on the settlement of tax disputes, and has been exploring the possible use of Alternative Dispute Resolution (ADR) techniques such as mediation, negotiation and arbitration, in an effort to determine if the appeals process could be improved.

Revenue Canada is now discussing with the departments of Finance and Justice the possibility of pilot testing the mediation technique, in order to assess its efficacy and effectiveness as an Alternative Dispute Resolution technique. Revenue Canada recognizes entirely the Auditor General's concern that in moving to ADR techniques due regard be given to the transparency of the process and the potential risks involved. The Department will proceed in a careful and well-planned manner in consultation with all parties involved. To this end, before proceeding with any possible pilot project on mediation, or other ADR techniques, guidelines for all staff will be developed to delineate the cases appropriate for mediation. As well, consultations will take place both with Justice, Finance and entities such as the Appeals Advisory Committee.

Conclusion

5.87 Upon completing our audit, we concluded:

- Revenue Canada and the Department of Justice regularly bring legislative deficiencies to the attention of the Department of Finance, and Revenue Canada has improved the quality of its proposals for legislative changes. However, the correction of legislative deficiencies and the time frame in which they are corrected is left to the discretion of the Department of Finance.
- As all three departments are key players in managing the risks arising from legislative deficiencies, it is important that they all be involved in deciding which deficiency should be given priority. This could be done through the interdepartmental committee of assistant deputy ministers.
- The management of tax litigation risks has been improved. However, more should be done.
- Settlements on income tax disputes resolved through consent judgments have been made on a mix of law and facts. Revenue Canada should provide more transparency in the settlements it undertakes.
- Revenue Canada and the Department of Justice need to strengthen the partnership arrangement for planning for litigation staff resources and Justice Tax Law Services has to move into the electronic age.
- To promote co-operative efforts in the areas recommended in this chapter and to facilitate the smooth administration of the tax system, efficient and effective relationships among Revenue Canada, the Department of Justice and the Department of Finance are essential. These three departments all play important roles in the administration of Canada's income tax system.

About the Audit

Objective

The objective of our audit was to assess the interdepartmental management processes in place for managing the risks to the tax base that are related to identified technical deficiencies in the *Income Tax Act* and that arise through the dispute resolution process.

Scope

Our examination was conducted in various offices of Revenue Canada and the departments of Finance and Justice and was limited to their activities. It consisted of interviewing staff and reviewing relevant systems and procedures, files and other documents. Our audit did not include a review of the Department of Finance's activities related to the development of tax policy or tax policy changes.

Criteria

There should be procedures in place to:

- consider the need for legislative changes to correct deficiencies;
- support the introduction, as early as possible, of draft amendments to correct identified legislative deficiencies;
- assess and monitor the risks of litigation;
- facilitate early and consistent settlements;
- provide transparency in settlement decisions; and
- plan for litigation staff resources.

Audit Team

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Chapter 6

Population Aging and Information for Parliament: Understanding the Choices

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Population Aging and Information for Parliament: Understanding the Choices

Main Points

6.1 Canada today is sitting on a very favourable demographic structure, with a historically low ratio of youth and elderly to the working-age population. In the coming few decades, this situation will be radically transformed. By the second decade of the next century, when the leading edge of the baby boom generation reaches normal retirement age, the growth in Canada's elderly population will accelerate while that of the working-age population will slow to a crawl.

6.2 This demographic shift has the potential to affect government finances in a significant way. An aging population puts pressure on government spending through higher pension payments and increased demands for health care services. Also, unless there are significant changes in the patterns of work, this demographic change will reduce labour force growth dramatically, which in turn would slow down economic growth and, with that, the growth in government revenues. This combination could put enormous pressures on our public finances when the full impact of this demographic change is felt by the second decade of the next century, particularly if Canada's debt burden and tax levels remain high.

6.3 The government is well aware of these pressures; during consultations on reforming specific programs like the Canada Pension Plan, it provided detailed projections of the effects of demographic forces on CPP finances. This longer-term information not only helped inform public debate, but also motivated acceptance of the need for change. To a lesser extent, as government began discussing reforms to Old Age Security and the Guaranteed Income Supplement (the Seniors Benefit), it again provided longer-term projections of the financial impacts.

6.4 Yet what it has done to highlight the impact of demographics on the financial health of individual programs, it has failed to do for the financial health of the government as a whole. Consequently, parliamentarians are left to make annual financial decisions, many of which have lasting consequences, without a macro perspective — a summing up of the financial impacts that demographics can potentially have on the government's long-term financial health.

6.5 The importance of appropriate information to help parliamentarians understand the government's financial condition is clearly a responsibility and a theme on which we have reported over the last six years. This chapter, illustrating the feasibility of preparing such longer-term information and the significance of that information, is a continuum of the "Information for Parliament" chapters in our 1993 and 1995 Reports. The particular contribution of this chapter is its focus on the role of demographics in assessing the government's financial condition.

Introduction

6.6 For some years now, this Office has emphasized the importance of improved financial reporting for achieving full accountability — in particular, the limitations of the information contained in traditional financial statements and the importance to decision making and accountability of information about the medium to long term.

6.7 Our 1992 Report stated that without a long-term focus, there is no anchor for short-term policies. In 1993, we suggested a series of five indicators that would help taxpayers understand how their tax dollars were being used. We also suggested that it was not enough to look simply at the past, but that this kind of information should be projected forward to show the long-term impact of current fiscal policies on these indicators.

6.8 Our 1995 Report continued the theme of the need for a longer view by indicating that most of the discussions about controlling government finances had been focussed on deficit reduction and balanced budgets. The government had not addressed the larger question of how much debt it could sustain over the long haul, and how that would fit within an overall view of taxation, the role of government and its impact on the Canadian economy.

6.9 Annual budget balances, desirable as they may be, have taken on an aura of importance as the pre-eminent scorecard of government accountability, rather than being recognized for what they truly are — only one of many components that provide an assessment of the government's overall financial condition. Simply relying on current deficits and debt ratios to come down does not provide a complete picture of financial condition, nor does it adequately identify the trade-offs Canadians need to make or the intergenerational choices that must be considered.

6.10 The government's response to our reports has been generally positive. Starting in 1994, it began producing an Annual Financial Report that included the five financial indicators we had proposed in 1993. More recently, the government has begun to pay more attention publicly to the debt-to-GDP ratio. To date, however, it has not provided Parliament with any specific debt targets or fiscal projections beyond two years ahead. The government's view seems to be that there is no need for a longer-term perspective as long as the debt ratio continues to fall. In our view this is insufficient, particularly if equity between generations is a concern. As we know, Canadians are facing choices today. To make those choices — particularly any changes to spending, taxation or debt reduction — Canadians need information about the impact their choices can have on government programs and how the financial burden of those programs will be shared between present and future generations.

6.11 The Minister of Finance alluded to these issues in his remarks to the House of Commons Standing Committee on Finance at the opening of the pre-Budget consultation process last fall, but put forward no specific discussion of their potential financial impacts. By contrast, when the federal government engaged the public in consultations about changing the Canada Pension Plan (CPP), it went much further and provided specific financial information about the difficulties the CPP would face in the coming decades because of predictable demographic developments. That information was provided to convince the public of the intergenerational inequity in the then-current contribution/benefit schedule. In our view, the funding and intergenerational issues that motivated action on the CPP are relevant to other areas of government spending as well.

6.12 To a lesser extent, the government is engaged in a similar exercise in the reform of the Old Age Security and Guaranteed Income Supplement programs. Missing, however, is a macro perspective — a summing up of the financial impacts that demographics can potentially have on the government's long-term financial health, and the importance that annual fiscal decisions have with respect to that health.

Focus of the study

6.13 Canada's public finances have shown dramatic improvement over the past few years. The federal government's initial fiscal target of reducing the deficit to 3 percent of GDP by fiscal year 1996-97 was surpassed by a wide margin. The most recent federal budget estimated a balanced budget for 1997-98 and forecast a zero deficit over the next two years as well.

6.14 This prospect has given rise to intense public debate about budgetary choices. However, this debate seems to be taking place in a vacuum of information about Canada's demographic profile and its potential impact on our public finances.

6.15 The objectives of this study were twofold:

- to demonstrate the significance of a long-term perspective to a proper appreciation of the government's current financial condition, with specific reference to the fiscal implications of current demographic trends; and
- to draw attention to the inadequacy of the information provided by the government to Parliament and the public about the implications of current demographic trends and their potential impact on current fiscal decisions.

6.16 Further details on the scope and conduct of the study can be found at the end of the chapter in **About the Study**.

Study Findings

Demographic Trends

The aging of the population

6.17 Canada's population is aging, meaning that the proportion of the total population who are elderly is increasing. In a little more than a decade, as the early members of the huge "baby boom" generation begin reaching age 65, the increase in Canada's elderly population will accelerate.

6.18 Canada's population has been growing older through most of this century, brought on by falling fertility and mortality rates over time. As Exhibit 6.1 shows, there was a pause in this trend between 1950 and 1970. That pause reflects the sharp increase in the number of births in the two decades following World War II.

Exhibit 6.1 is not available, see the Report

Proportion of People Aged 65 and over in the Total Population, Canada, 1911 to 2031

6.19 From fewer than 250,000 per year during the 1930s and early 1940s, births soared to a yearly average of 425,000 between 1946 and 1965. Those born over this 20-year period represent the so-called baby boom generation. A baby "bust" followed, with births falling well below 400,000 a year over the past three decades, despite a much larger population base. The fertility rate — the lifetime number of births per woman — plummeted from over 3.5 during the baby boom years to 1.7 over the past two decades, a rate significantly lower than the replacement rate of 2.1, the rate needed to maintain the population at a constant level in the absence of net immigration. (For a discussion of the source and nature of the demographic projections, see Exhibit 6.2.)

Exhibit 6.2

Note on Population Projections

Unless otherwise indicated, all demographic data in this section, including projected data, are taken from Statistics Canada sources.

Statistics Canada prepares four sets of population projections, using different assumptions concerning fertility, mortality and immigration. The projections reported here represent the medium-growth scenario. This assumes a fertility rate of 1.7, continuing increases in longevity but at a diminishing growth rate, and immigration of 250,000 a year.

6.20 The baby boomers will begin reaching normal retirement age by about 2010. Over the subsequent two decades, as successive cohorts of this generation join the ranks of the population aged 65 and over, the size of this age group will expand greatly.

6.21 Another factor contributing to this expansion is that people are living longer, the result of improvements in medical services and better living standards. In 1952, when Old Age Security was first introduced (with eligibility for benefits to begin at age 70), a Canadian at birth was expected to live to 68.5 years. Today the average life expectancy is 78.5 years and is expected to grow to 80 years by 2016. In 1952, a 65-year-old Canadian was expected to live another 14 years on average. Today, life expectancy at 65 is over 18 years. In other words, over time, a growing proportion of Canadians are living long enough to qualify for social security benefits and on average they receive them for a longer time.

6.22 The onset of retirement of the baby boomers, together with gains in life expectancy, will result in rapid expansion of Canada's elderly population in the second and third decades of the next century. According to projections by Statistics Canada, the population 65 years and over will grow gradually from some 3.6 million today to five million by 2011 and then will soar to nine million by 2031 (see Exhibit 6.3). The rest of the population is also expected to grow over this period, but much more slowly. As a result, the proportion of the total population who are elderly will almost double, from 12 percent today to 22 percent by 2031. The elderly dependency ratio — the ratio of the population 65 and over to the population aged 20 to 64 — is also projected to nearly double, from 20 percent today to over 38 percent by 2031.

Exhibit 6.3

Population Trends - Selected Years

	Projections				
	1960	1976	1996	2011	2031
Population					
Total	17,870	23,517	29,964	35,420	41,216
Elderly (65 and older)	1,358	2,026	3,642	4,981	8,937
Elderly as a Proportion of Total Population	7.6	8.6	12.2	14.1	21.7

6.23 The oldest among the elderly will experience the fastest growth in numbers. The population aged 80 and over will almost quadruple over the next 45 years, growing from about 820,000 today to some 3.1 million in 2041. Its proportion of the total population will swell from less than 3 percent today to over 7 percent, or from 23 to 33 percent of the elderly. In short, over the next few decades, Canada's population of elderly will increase substantially and so will their average age.

6.24 The actual demographic future may differ from the one projected, but not significantly. The people who will be retiring over the next few decades are already in the current population. Changes in fertility rates are not easily susceptible to policy influence. At any rate, changes in fertility will not have a significant impact on the labour force for at least two decades. Finally, immigration levels are the only policy lever that can affect the population mix in the medium term. But its potential is limited, simply because even a doubling of current immigration levels would result in only a marginal decrease in the ratio of the elderly to the working-age population over the next few decades.

The role of a declining youth population

6.25 It may be argued that concentrating on the elderly exaggerates the impending demographic pressures because it ignores potential savings from a youth population that is declining in relation to the working-age population — the youth dependency ratio. As Exhibit shows, this ratio declines gradually through most of the projection period, so that the total dependency ratio (youth plus elderly) does not rise as rapidly as the elderly ratio alone.

Exhibit 6.4 is not available, see the Chapter

Population Dependency Ratios 1993-1996 and Projections to 2031

6.26 However, relying on these raw numbers as a basis for assessing the potential financial impact of the dependency ratio would be misleading because youth and the elderly do not represent equivalent demands on government spending. Estimates for Canada suggest that per capita spending on the elderly is two to three times greater than on the young.

6.27 Exhibit 6.5 shows elderly and youth dependency ratios, and ratios adjusted for the estimated differences in public spending on the young and the elderly. The table shows that on an expenditure-weighted basis, dependency ratios in the coming decades will be not only much higher than today but also higher than the high ratios of 30 to 40 years ago.

Exhibit 6.5

Dependency Ratios, Crude and Expenditure-Adjusted - Selected Years

	Projections				
	1960	1976	1996	2011	2031
Dependency Ratio ¹					
Elderly	14.9	15.4	19.9	22.6	38.2
Youth	81.3	63.8	43.7	37.9	38.1
Total	96.2	79.2	63.6	60.5	76.3
Expenditure Ratio ²					
Elderly	25.4	26.2	33.7	41.6	70.5
Youth	55.5	43.5	29.8	23.3	23.4
Total	80.9	69.7	63.5	64.9	93.9

Demographic Changes and Economic Growth

6.28 How economies grow is not well understood. One can nevertheless draw meaningful inferences about the relationship between demographics and economic growth by concentrating on the two basic factors contributing to output — namely, capital and labour. An aging population can affect economic growth through the amount that the nation saves, and therefore invests, and through changes in labour force growth.

Demographic developments will tend to depress domestic savings

6.29 Total savings in the economy are made up of savings by the private sector and by governments. Demographic shifts can affect private as well as public saving rates.

6.30 Among individuals, a strong reason for saving is to smooth consumption over time. Typically, people consume a higher proportion of their income in their early years (when incomes are low), less during middle age, and then more again during retirement. The pattern of saving is the reverse of the consumption pattern.

6.31 This pattern of consumption/saving suggests that baby boomers, who are now in their peak earning years, are also in their peak saving years. Other things being equal, then, personal savings may fall over the next few decades as this generation ages and leaves the work force for retirement. By how much savings may fall is difficult to say, because we lack good estimates of the responsiveness of saving to changes in life circumstances.

6.32 Government saving is also negatively affected by the population's aging. An aging population brings on pressures for governments to spend more, which is tantamount to saving less. The result is that Canada could experience a significant drop in total savings (private and government combined) during the second and third decades of the next century.

6.33 This prospect's relevance to government finances stems from the effect that savings have on economic growth and therefore on government revenue growth as well. Saving is the means to investment. Low rates of saving imply either low rates of domestic investment or higher foreign indebtedness, if we borrow abroad to keep investment levels high. Lower investment means lower capital per worker and hence lower productivity and income growth. Higher indebtedness to foreigners means that a higher proportion of incomes generated domestically accrues to non-residents in the form of interest or dividend payments. In either case, a reduction in the level of our domestic saving would leave future Canadians economically less well-off and the tax base available to Canadian governments correspondingly smaller.

Growth in labour force will slow sharply in coming decades

6.34 The number of people in the labour force depends on two factors: the size of the working-age population and the proportion of that population that is either working or looking for work — that is, the labour force participation rate. Over the next few decades, labour force growth is expected to slow down because of changes in both of these factors.

6.35 According to Statistics Canada projections, the annual increase in Canada's working-age population will fall from an average rate of 1.6 percent over the past 20 years to less than 1 percent during the second and third decades of the next century. Growth in the labour force will decline even more because the labour force participation rates are also expected to fall.

6.36 The anticipated reduction in labour force participation rates is also due to demographic factors. In the coming decades, an increasing proportion of the working-age population will fall within older age groups, which

are characterized by lower participation rates. In particular, the baby boom generation is currently at its peak participation age (30 to 50 years old). As it grows older and its attachment to the labour force weakens, it will tend to pull down overall participation rates. Of course, factors other than demographics — factors such as wealth and income levels, social policies and attitudes — also affect labour force participation rates. Our projections do not reflect such factors, because their long-term impact is more difficult to assess than that of demographics.

6.37 Exhibit 6.6 shows historic and projected labour force growth rates over specific periods to the year 2031. The anticipated reduction in participation rates together with a slowdown in the growth of the source population result in a marked projected decrease in labour force growth over the next decade. By the second and third decades of the next century, as baby boomers leave the work force for retirement, labour force growth will slow to a near standstill.

Exhibit 6.6

Labour Force Trends

	Projections			
	1976-96	1996-2011	2011-2021	2021-2031
	<i>(average growth rates - %)</i>			
Source Population	1.5	1.4	1.1	0.7
Participation Rate	65.2	62.1	58.8	55.8
Labour Force	1.8	1.1	0.4	0.2

6.38 This labour market outlook has a direct effect on the expected rate of economic growth. Growth consists essentially of the sum of growth in employment and in productivity, or output per person employed. As labour force growth weakens, therefore, so will economic growth unless productivity improvements offset the declines in employment growth.

6.39 Over the past 20 years, real GDP growth in Canada has averaged 2.6 percent a year. Productivity improvements accounted for approximately one third of this growth and employment growth for two thirds. Given the labour force projections we have outlined here, the contribution from employment growth will fall sharply in the years ahead. During the second and third decades of the next century, economic growth will be confined to essentially the rate of growth in productivity. If the productivity performance over these decades parallels that recorded over the past two decades, GDP growth will slow to little over one percent a year. To attain the average growth rate recorded since the mid-1970s, the rate of productivity growth will have to more than double.

Higher rates of productivity growth are possible but not assured

6.40 Increases in labour productivity can come about in essentially two ways: increases in efficiency through the way labour and capital are combined (economists call this Total Factor Productivity — TFP), and increases in the amount of capital per worker. Over the past two decades, gains in TFP have been weak, despite technological innovations and structural changes in Canada's economy like tax reform, financial services deregulation and freer trade.

6.41 There are some who believe that this trend may change because of the revolution in information technology. There are also those who argue that the productivity effects of information technology are likely to remain small, either because the effects of computers are in fact relatively small or because they are not captured by official output data — for example, the benefits attached to Internet or banking machine access. If this view is correct, information technology may not show a large payoff in measured GDP growth.

6.42 Labour productivity could improve even without improvements in overall efficiency, if labour had more capital to work with. But with the potentially adverse impact of an aging population on saving rates, and consequently on capital, most long-range forecasts of the Canadian economy in fact show a declining growth rate for the capital stock in the coming decades.

6.43 In light of these considerations, significant increases in productivity growth are not assured. For the fiscal projections reported later in this chapter, we assume labour productivity will increase at an annual rate of one percent, only marginally higher than the average productivity growth experienced since the mid-1970s.

6.44 As already indicated, economic growth is basically the sum of growth in productivity and in the labour force. Then, if the rate of productivity growth remains roughly constant and there is a marked slowdown in labour force growth over the next few decades, this implies that economic growth will also decline markedly (see Exhibit 6.7).

Exhibit 6.7 is not available, see the Report

Economic Growth Projections

Demographic Changes and Government Spending

6.45 Changes in the age structure of a population probably affect every category of government spending to some degree. Three areas of spending, however, are particularly sensitive to demographic shifts: social security, health care and education. Because the share of the school-age population does not change over the projection period enough to significantly affect government spending, we considered the effect of aging only on spending for social security and health care. While not all the elderly will be dependent on publicly funded pensions and services, many of them will be, putting pressure on government spending for social security and health care. In this section we illustrate that under current policies, government spending in these two areas will grow considerably faster than GDP in the coming decades, even with fairly conservative assumptions concerning future increases in health costs.

Government spending in social security will accelerate

6.46 Canada's retirement system is described briefly in Exhibit 6.8. The public components of that system are financed essentially on a pay-as-you-go basis. In other words, benefits to existing beneficiaries are paid for by levies on the employment earnings of current workers (in the case of the Canada/Quebec Pension Plans) or from general tax revenues (for Old Age Security and Guaranteed Income Supplement). In short, they are financed essentially by transfer payments from the working-age population to the retired population. As the proportion of the elderly increases, the burden on the working-age population will also increase.

Exhibit 6.8

Canada's Retirement System at a Glance

Canada's retirement income system comprises three basic pillars: a publicly financed system of pension benefits — the Old Age Security (OAS), Guaranteed Income Supplement (GIS) and Spouse's Allowance (SPA) programs; a contributory system of pensions, compulsory for all employed Canadians between the ages of 18 and 65 — the Canada Pension Plan and the parallel Quebec Pension Plan; and a tax-assisted system of private savings — employer-sponsored registered pension plans (RPPs) and individual registered retirement savings plans (RRSPs).

A universal old age pension system was first introduced at the federal level in 1952 (a means-tested pension jointly funded by the federal and provincial governments had been in operation since 1927). Until 1965, OAS benefit eligibility began at age 70. It was then annually lowered by a year to 65 in 1970, where it remains today. The GIS was introduced in 1967; it is payable to all OAS recipients

who have limited income from non-OAS sources. A spouse's allowance was introduced in 1975, payable to spouses aged 60 to 64. In 1984, the allowance was extended to widows and widowers aged 60 to 64. Since 1989, OAS benefits have been "clawed back" at a rate of 15 percent of the beneficiary's annual income in excess of a specified threshold that is partially indexed to the CPI.

The CPP/QPP was introduced in 1966. Financed through compulsory contributions by both employers and employees, it provides retirement pensions essentially equal to one quarter of average contributory earnings. Normal retirement age for the CPP/QPP is 65, but contributors may retire as early as 60 at reduced benefits or defer retirement to age 70 and receive higher pensions.

RPPs are employer-sponsored arrangements under which money is set aside during the working life of employees to provide them with income at retirement. RRSPs are individual retirement accounts administered by regulated financial institutions. The *Income Tax Act* encourages the establishment of RPPs and RRSPs by allowing contributions to such plans, up to a specified maximum, to be deducted from taxable income and by exempting the pension plans' income from taxation.

6.47 Exhibit 6.9 displays projections of social security spending to the year 2031, when all baby boomers will have reached retirement age. These projections are based on data provided by the Chief Actuary and assume a one percent annual growth in real wage rates. Projections for the QPP are based on the assumption that future outlays under that program will remain a constant percentage of CPP outlays. Under these assumptions, total CPP/QPP outlays are projected to grow from 2.7 percent of GDP in 1996 to 4.7 percent in 2031.

Exhibit 6.9 is not available, see the Report

Projected Social Security Spending as a Percentage of GDP Projections to 2031

6.48 The projections for OAS/GIS do not incorporate changes under the proposed Seniors Benefit, since this reform has not yet been legislated and its final form was not known at the time this chapter was completed. Under the existing program, increases in OAS spending lag behind GDP growth in the earlier years of the projection period (since these benefits are linked to prices, not wages), but accelerate past it in the second decade of the next century when the leading edge of the baby boomers reaches OAS eligibility age. By 2031, OAS outlays are projected to rise to 2.9 percent of GDP compared with 2.0 percent today.

6.49 Expenditures under the GIS program also rise over the projection period, but less than OAS benefits and only marginally more than the economy as a whole. This is because GIS benefits are income-tested and thus tend to fall as other income sources grow.

Population aging will intensify pressures on medicare

6.50 Medicare consists of universal, publicly funded access to hospital and physician services. According to Health Canada figures, in 1996 all levels of government in Canada spent an estimated \$52.6 billion on health care, or 6.4 percent of GDP. Cost containment efforts in recent years have resulted in a reduction of health care spending as a share of GDP; that share peaked at 7.5 percent in 1992. In the 1970s, medicare spending averaged less than 5.5 percent of GDP. Most of the growth experienced since then is accounted for by higher spending per user on more and better services and by the relatively higher costs of those services. Even if future increases in per capita spending prove to be lower than in the past for every age group, medicare expenditures overall will rise as the population ages.

6.51 Health care costs follow a pattern that varies with age. They tend to be relatively high in the earliest years, fall significantly during youth and young adulthood, rise gradually during middle age and then quite steeply during old age (see Exhibit 6.10). Generally, as people age they become more susceptible to illness and health problems that may limit their ability to function independently. The incidence of disabilities, for instance, increases significantly with age. The elderly are also more likely to require physician services, hospitalization or nursing

home care. On average, per capita public spending on health for those aged 65 and over is almost five times greater than per capita spending on the rest of the population.

Exhibit 6.10 is not available, see the Report

Health Care Spending per Capita by Age Group 1993

6.52 While health care costs are likely to rise as the population ages, projections of these costs are difficult to make with any degree of confidence because, in addition to demographics, they depend on many other factors that are highly uncertain. These include trends in the state of health of the elderly and relative inflation in the health care sector. They also include developments in technologies and treatments that, while adding to the quality of service, also tend to increase demand for health services and the need for highly trained — and highly paid — specialists. Finally, changes in the ways medicare services are organized and delivered can also significantly affect health care costs in the future.

6.53 Exhibit 6.11 shows the results of three separate health cost projections:

- a high-cost projection, which assumes that future age-specific per capita health costs rise at roughly the same rate as that experienced over the past two decades;
- a medium-cost projection based on the assumption that per capita health costs rise at the same rate as average wages (which are assumed to increase at an annual rate of 1 percent in real terms); and
- a cost-containment scenario in which health spending per capita rises only with the general price level, that is, age-specific health spending per capita remains constant in real terms.

Exhibit 6.11 is not available, see the Report

Projections of Public Health Care Expenditures as a Percentage of GDP to 2031

6.54 We include the third projection — that real per capita health costs remain constant — to isolate the purely demographic effects on health spending. Even with this freeze, overall public health spending would rise significantly in absolute terms, and at about the same rate as projected GDP growth. In both of the other two projections, health care spending rises much faster than GDP over the projection period. In the medium-cost case, health spending rises from 6.4 percent in 1996 to 9.0 percent by 2031. In the “high cost” case, health spending as a share of GDP doubles to 12.5 percent over the same period.

6.55 Exhibit 6.12 summarizes the results of all the foregoing projections. It shows that government spending on social security and medicare rises from 11.6 percent of GDP in 1996 to somewhere between 14.7 and 20.7 percent by 2031, depending on the assumptions about health care cost increases. In the medium-cost projection (which has per capita health costs increasing at the same rate as the average wage), government spending on social security and health rises to 17.2 percent of GDP by 2031, 5.6 percentage points higher than today. In today’s economy, such an increase is equivalent to roughly \$50 billion.

Exhibit 6.12

Government Spending on Social Security and Health - Selected Years

Projections				
	1996	2011	2021	2031
<i>(as a percent of GDP)</i>				

CPP/QPP	2.7	3.4	4.2	4.7
OAS	2.0	2.1	2.5	2.9
GIS	0.5	0.5	0.5	0.6
Health				
Low ¹	6.4	6.2	6.4	6.5
Medium ²	6.4	7.1	8.1	9.0
High ³	6.4	8.1	10.1	12.5
Total				
Low	11.6	12.2	13.7	14.7
Medium	11.6	13.1	15.4	17.2
High	11.6	14.1	18.4	20.7

¹ age-specific per capita health spending rises with inflation

² age-specific per capita health spending rises at 1% real

³ age-specific per capita health spending rises at 2% real

Demographic Changes and Government Finances

6.56 Our discussion of the implications of aging indicates that under current policies, increases in government spending on social security and health care could very likely accelerate within a little more than a decade. At the same time, economic growth and government revenue growth are likely to slow down considerably. Together, these forces can result in significant pressures on public finances starting around 2010, when the baby boomers begin reaching retirement age. How well the next generation and its governments are able to cope with these pressures will be determined largely by annual fiscal decisions made over the coming years. The difficulty is that decision makers are not being provided with sufficient information to understand the potential impacts of demographics, and how these impacts relate to current fiscal decisions.

Current budget decisions have long-term fiscal implications

6.57 To provide insight into the kind of information that Canadians need to understand the relationship between annual fiscal balances and intergenerational equity, we projected three fiscal scenarios to the fiscal year 2010, roughly the start of retirement for the baby boom generation. These scenarios can be viewed as different ways of dealing with annual budgetary balances over the next decade or so, before the looming demographic pressures bear down on our public finances. We then discuss the implications of these different scenarios for program spending in the years beyond 2010.

6.58 The assumptions characterizing each scenario are set out in Exhibit 6.13. In all three scenarios, government revenues are assumed to rise with the growth of the economy, so that the revenue share (as a percentage of GDP) stays constant throughout the projection period. The effective real interest on government debt is set at 5 percent, a rate that is high by historic standards but lower than the average rate over the past two decades. Government outlays on social security rise according to the projections discussed in the previous section. Spending on health care is made to rise with health care spending in general, which in turn is assumed to rise according to the “medium cost” projection set out in the previous section. (Modelling health spending this way may be questioned, since federal spending on health consists primarily of transfers to the provinces, which are not tied to actual spending on health. For a discussion of the rationale for this assumption, see Exhibit .6.14)

Exhibit 6.13

Assumptions Used for Projections

Economic and fiscal assumptions common to all scenarios	
Growth in labour productivity	1.00%
Inflation rate	2.00%
Government revenues	rise at the rate of nominal GDP
OAS/GIS growth	indexed to CPI
Per capita health spending	rises with average wages (1% in real terms)
Interest rate on debt	5% real

Fiscal policy assumptions to year 2010	
Scenario 1:	“Discretionary” spending* grows with inflation only
Scenario 2:	?Balanced budget
Scenario 3:	“Discretionary” spending* grows with nominal GDP

*Program spending other than spending on health care and old age pensions.

Exhibit 6.14

Health Expenditure Assumptions

Other than a relatively small portion of direct spending (primarily for service delivery to native Canadians on reserves and to military personnel, and for funding of health protection and promotion activities), federal spending on health consists of contributions to the provinces. These contributions have been effectively decoupled from actual spending on health since 1977, when cost sharing of health expenditures was replaced by a block funding formula under the Established Programs Financing (EPF) Arrangements. EPF tied federal transfers for health and post-secondary education financing to growth in population and the economy, rather than to actual spending on these programs. This basic approach has continued under the Canada Health and Social Transfer, which replaced EPF in April 1996.

Nevertheless, it is probably unrealistic to assume that federal finances will remain unaffected by the increases in health care pressures, particularly since, under the *Canada Health Care Act*, the federal government retains authority for setting standards in the health care field. As spending pressures in the health sector mount, it is likely that either federal contributions will have to be increased or federal tax rates will have to be reduced to provide provinces with room to increase their own rates. This is essentially what has taken place in the past, and it is nothing more than recognition of the fact that in the end, there are two governments taxing one taxpayer.

6.59 The three scenarios differ only in the assumptions we make about government “discretionary” spending (program spending in areas other than health and social security), and in the budget balances and debt levels that result from these assumptions.

6.60 Scenario one can be characterized as a case where the entire projected surplus is used for debt reduction. It represents essentially a continuation of the policy of fiscal restraint the government has been following in recent years. In this scenario, discretionary spending to the year 2010 is allowed to rise only with inflation. The fiscal surpluses resulting under this policy, while small at first, grow quickly over time, causing a correspondingly sharp reduction in the government debt. By 2010, the debt-to-GDP ratio shrinks to 23 percent, roughly the same ratio as in the mid-to-late 1970s (see Exhibit 6.15).

Exhibit 6.15 is not available, see the Report

Debt-to-GDP Projections to 2015

6.61 Scenario two can be viewed as a case where all projected surpluses are spent. That is, the budget is kept in balance till the year 2010. This scenario would allow discretionary spending to increase year over year, both in real

terms and in relation to the GDP. The stock of debt remains unchanged in this scenario, but the debt-to-GDP ratio falls as the economy grows. Given the economic growth underlying the projections, the debt ratio falls to 42 percent by 2010, which is where it was approximately 14 years ago.

6.62 Scenario three is an intermediate option, where part of the projected surplus is spent and part is used to reduce the debt. More specifically, this scenario assumes that discretionary spending beyond the year 2000 rises at the same rate at which the economy grows. Given the large operating balance at the beginning of the projection period, this scenario also results in substantial and growing budget surpluses over time, though smaller than in the first scenario. The debt-to-GDP ratio in this case falls to about 33 percent by 2010, its level in 1982.

6.63 Clearly, the debt-to-GDP ratio falls significantly from current levels in all three scenarios, but never lower than it was 20 years ago. Moreover, the run-up in debt we have experienced since the mid-1970s occurred despite favourable demographic conditions, with the labour force growing strongly and dependency ratios declining. By contrast, in the years after 2010, labour force growth will be weak and dependency ratios will be rising. In this context, despite the 10 years of fiscal consolidation represented by each scenario, the government's financial health will still be poorer when baby boomers begin leaving the labour force than when they entered it.

6.64 The projections of discretionary spending in the years beyond 2010 help illustrate this point. Exhibit 6.16 shows average spending on government programs other than social security and health care ("discretionary spending") as a percent of GDP for specific periods to fiscal year 2032. It also shows discretionary spending during 1976-97, for comparison purposes.

6.65 Projections to the year 2010 show the results of the three scenarios described above. Projections beyond 2010 are calculated on the assumption that the debt-to-GDP ratio is held constant at the level where it happens to be in 2010 under each of the three scenarios. The assumptions concerning government revenue growth, interest costs and "entitlement spending" (spending on social security and health) stay the same as before. Discretionary spending is adjusted to maintain the fiscal balances required to keep the debt ratio constant.

6.66 A number of observations follow from the results displayed in Exhibit 6.16.

Exhibit 6.16 is not available, see the Report

Discretionary* Program Spending to GDP - Historical and Projected Averages under Three Different Fiscal Scenarios

6.67 First, under all three scenarios, discretionary spending over the next decade is much lower than in the years thereafter. In part, this represents the price of bringing the debt ratio down, which means that until 2010 the budget is kept in surplus or in balance. It also represents the payoff from this period of fiscal restraint: with a much lower debt burden in the years beyond 2010, a smaller portion of the budget is absorbed by debt service costs and more is left over for program spending.

6.68 A measure of the payoff from fiscal restraint is also provided by the differences in the level of discretionary spending associated with each scenario. A policy of "banking" prospective surpluses over the next decade, such as that of scenario one, results in a level of "discretionary" spending in the long term that is approximately 6 percent higher than under the balanced budget scenario. In today's economy, this amounts to approximately \$5 billion. But even in the most stringent of the three scenarios, discretionary spending in the second and third decade of the next century remains well below levels experienced in the 1970s and 1980s.

6.69 Each of the three scenarios in effect represents a particular fiscal path to the year 2010. The greater the fiscal restraint associated with a path — that is, the more of the potential surpluses we "bank" rather than spend along the way — the smaller will be the stock of debt at the end of it. A lower debt implies lower debt service

payments, and therefore more spending available for programs at any given revenue level. In short, the more we spend today, the less we or our children can spend tomorrow.

6.70 Finally, Exhibit also shows that discretionary spending (relative to the size of the economy) is lower in the second half of the period 2011-32 than in the first. This decline reflects primarily the pressures of entitlement spending (OAS/GIS and health) on other programs. As discussed earlier in this chapter, the growth of Canada's elderly population will accelerate during the second and third decades of the next century, as the huge baby boom generation joins the ranks of those over 65. Under current policies, this aging trend will result in significant increases in government spending on social security and health care. If these spending increases are to be met without increasing the overall tax burden or the level of indebtedness, government spending in other areas will have to fall.

6.71 In all of the three scenarios discussed here, discretionary spending is the variable that adjusts to meet the different policy-determined fiscal targets. This way of casting policy was done for ease of exposition only. The same targets could also be met through tax changes or through a combination of tax and spending measures.

6.72 Any long-term projections are highly speculative. They are based on assumptions that may turn out to be wrong. But while precise outcomes are uncertain, the overall trend is not: the ratio of working to non-working population will shrink dramatically in the next few decades and this will increase pressures on government spending while reducing the government's capacity to respond. How serious these effects turn out to be will depend crucially on policies followed in the meantime to minimize their impact. Clearly presented long-term projections, made available to Parliament and the public, can help identify the fiscal challenges that lie ahead and the trade-offs associated with different options for dealing with them.

Government Initiatives

Many countries are budgeting within a long-term framework

6.73 Population aging is not unique to Canada. Most developed countries and much of the third world will undergo a similar experience in the coming decades. A number of international agencies, the OECD and World Bank in particular, have been engaged in major research programs to estimate the impact of aging populations on public finances and to identify ways of dealing with the fiscal challenges involved. In recent years, many individual countries have also made a point of reforming their fiscal reporting to reflect more fully the long-term fiscal pressures associated with population aging.

6.74 The United States and Denmark have probably moved further in this direction than most. Both countries prepare and make public projections of fiscal balances under various assumptions 40 to 50 years ahead. Demographic impacts on public finances are explicitly considered in these projections.

6.75 Other countries, while not engaged in detailed long-term projections, nevertheless supplement their fiscal statements in other ways that introduce a long-term perspective in budget decision making. In New Zealand, for example, the government is required by law to establish long-term fiscal objectives and to discuss in the budget how the government's fiscal plans support those objectives. As part of this process, the New Zealand government has begun reporting on the demographic pressures looming over the following several decades and how these could affect the government's fiscal position. Legislation similar to that of New Zealand is currently before Parliament in Australia.

6.76 Another way of bringing a long-term perspective to budget making is through the production of so-called generational accounts (see Exhibit .6.17). Generational accounts have been provided in recent years by governments

in the U.S., Argentina, New Zealand and Norway. In November 1997, the UK government announced a project to develop such accounts for the UK as well.

Exhibit 6.17

Generational Accounts

Generational accounts provide a framework for measuring the net impact of fiscal policies on present and future generations. Fiscal policies consist of the taxing and spending decisions of governments. The benefits governments provide their citizens, whether in the form of services or transfer payments, are funded through basically two ways: taxes and borrowing. Generational accounts begin with the basic proposition that money borrowed today will have to be paid for at some time in the future. This means that future taxes must be large enough not only to cover future benefits but also to pay off the net debt accumulated to date. Based on this proposition and on assumptions about demographic and economic trends, generational accounts estimate the net benefits (benefits less taxes) of typical members of different generations.

Canada is not among them

6.77 Compared with the budget processes just described, the time horizon of Canada's fiscal framework is very short. The fiscal plans presented with the annual budget extend only two years ahead.

6.78 Regular long-term actuarial analyses of the CPP, the OAS, and several public service pension plans are carried out because legislation requires them. Except for these analyses, however, there is no legal requirement for long-term financial projections of other government commitments, and none is made on a regular basis. A study on the cost of government and expenditure management was completed in 1992 by a joint federal-provincial working group at the request of ministers of finance and treasurers. Part of that study examined future pressures on government spending and provided long-term projections (to the year 2025) of expenditures on health, education and social services, under various economic and demographic assumptions. Also, a number of internal studies have been prepared that look at the long-term economic implications of aging. In the fall of 1997, the government sponsored a conference of experts to discuss such implications.

6.79 More recently, the Department of Finance has developed an economic model that is capable of making long-term projections of potential growth of the Canadian economy. It would not require significantly more resources to supplement that model with a fiscal component that would enable the Department to also prepare long-term projections of budget balances and debt levels.

Conclusion

6.80 Population aging is not a hypothetical problem but a real event that is occurring now. We are living longer and we are having fewer children. These are indisputable facts.

6.81 Also indisputable is the fact that these demographic trends will have a significant impact on the economy down the road. Aging affects the amount and the way we save and therefore the amount we invest in the economy; aging also affects the size and composition of the labour force, which in turn affects the growth in the economy. Of course, events can change, but no event can change the reality that we have a baby boom bulge and that our fertility rates have been below rates that would sustain the existing population level. Unless our productivity somehow increases significantly or patterns of work and retirement change substantially, the current demographic trends suggest that the growth in the economy and the associated growth in government revenues will tail off in the coming decades.

6.82 Demographics can also have an impact on government spending. Under current legislation, the combined costs of Old Age Security and the Guaranteed Income Supplement will rise both in absolute terms and relative to

GDP. Health costs in the economy as a whole will also rise relative to GDP. How much this will affect actual federal expenditures depends on a number of factors, including the continuance of the existing fiscal transfers, the likelihood that new federal programs like pharmacare and home care will be introduced, and other elements that could affect the federal share of health care expenditures. But if the federal share falls, someone somewhere will have to pick it up, whether it is the provinces or private health care arrangements. Since there is only one taxpayer, if private or provincial financial responsibilities increase there will be pressure to reduce federal taxation.

6.83 The exact magnitude of the impending demographic impact is not certain. However, the direction is clear. We do know that the lower the debt ratio becomes, the easier it will be for future governments to meet commitments to seniors and to fund other program areas like the environment, science and technology, and education. The scenarios we projected point out the nature and extent of the trade-offs involved.

6.84 Of course, events could change that might affect labour force growth or even productivity. Events could also affect the federal government's cost and share of health care. In any case, it is possible to demonstrate that demographics do matter, and that they can affect the long-term financial condition of government.

6.85 The government recognizes this and has done a considerable amount of work on this theme. The Department of Finance has supported academic workshops to encourage debate on the issue and it has built a long-run model to assess the factors involved. To date, however, the government has not made projections of this kind publicly available.

6.86 As an audit office, our role is not to compete with or supplement the work of think tanks and forecasting services that provide a range of predictions for the Canadian economy and government financial health. Our responsibility, among other things, is to comment on the credibility, reliability, and understandability of government financial reporting. As we have said many times before, that means looking forward, to understand the impact that the future holds in assessing current financial health. In this regard, it is our view that the government has not been sufficiently forthcoming in providing Canadians with information to allow them to make choices that affect not only them today but also generations down the road.

6.87 In this regard, to help legislators and Canadians gain a better appreciation of the fiscal challenges looming ahead, the government ought to produce long-term financial projections on the basis of status quo policies and alternatives. These projections would then be reported to Parliament, either as part of the annual budget presentation or during pre-budget consultations. There are two main reasons for doing this: first, the more transparent information is, the better its quality becomes. There is an expression that "sunlight is the best antiseptic". In this case, even if government projections are not perfect (as is inherent in any projection), public exposure will allow greater scrutiny and ultimately improve the information. The second reason is that if the information is made available publicly, Parliament and the public can better appreciate the long-term fiscal implications of current budgetary choices.

6.88 Finally, in making these suggestions, our purpose is not to put the government in a position of being accountable for financial results five, ten or twenty years down the road. Clearly that would not be fair or feasible. No government could ever publish estimates of its revenues or expenditures for the medium to longer term that it could guarantee it would meet. In this regard, being accountable for two-year rolling targets seems very defensible.

6.89 Yet dealing with the potential fallout that an aging society can have on government's long-term financial condition requires making intelligent choices today. And providing information to help parliamentarians with those choices is not about being accountable for the longer term, but simply taking the longer term into account. At this juncture, with the aging of the population a virtual certainty, we believe that for government financial reporting to be useful, telling people about the potential impacts that demographics can have is fundamental.

Department's response: *The government continues to conduct its fiscal planning based on a simple strategy — that of achieving long–run goals by setting and meeting realistic short–run targets. This is a measured and responsible approach. It is also an effective approach.*

Moreover, government financial management is not taking place in isolation; rather, government policy is being carried out with full awareness of the fiscal implications of population aging. The government and the Department of Finance have taken concrete steps in both analyzing and addressing the problem of population aging.

Indeed, the very extrapolations contained in the chapter largely replicate the results of a study produced six years ago by a joint working group of Department of Finance and provincial treasury officials. The government is also currently participating in the G-10 Working Party on the Aging of Populations, which is further investigating the economic and fiscal implications of population aging (population aging is not a phenomenon unique to Canada).

Beyond simply studying the issue, the government has proposed two important policy changes to ensure that our public pension system can be sustained in the face of changing demographics. The first was the 1996 Budget proposal to replace the current Old Age Security and Guaranteed Income Supplement programs with the Seniors Benefit. The fundamental objective of the proposed reform is to slow the growth in costs while protecting and enhancing pensions for low– and modest–income seniors. The second was the recent agreement between the federal and eight provincial governments to reform the Canada Pension Plan. This reform will ensure that the CPP program remains financially sound in the long run and continues to be in place for future generations.

The government believes that presenting long–run fiscal projections to Parliament every year would serve only to detract attention from the important goal of debt reduction. The best approach to fiscal management is the considered and deliberate one of achieving long–run goals through realistic short–run targets, and taking tangible measures to ensure that programs remain sustainable in the face of upcoming demographic changes.

About the Study

Objectives

The objectives of this study were twofold:

- to demonstrate the significance of a long-term perspective to a proper appreciation of the government's current financial condition, with specific reference to the fiscal implications of current demographic trends; and
- to draw attention to the inadequacy of the information provided by the government to Parliament and the public about the implications of current demographic trends and their potential impact on current fiscal decisions.

Scope and Approach

The study focussed on projected demographic developments over the next three to four decades and the implications of these developments for government revenues and expenditures. It also examined the federal budgetary process, with special emphasis on fiscal projections by the Department of Finance and the public reporting of those projections.

The findings of the study were based on:

- a review of published information on demographic trends and their long-term fiscal implications;
- Statistics Canada census and economic data and population projections;
- actuarial projections by the Chief Actuary of the OAS/GIS and CPP programs;
- examination of internal studies and working papers on demographics and economic growth by the Department of Finance, and interviews with departmental officials;
- a review of budgetary reporting practices in Canada and several other developed countries.

The choice of the projection period, to the year 2031, was dictated by our interest to capture the impact of the retirement bulge represented by the aging of the baby boom generation and still remain within a reasonable time frame.

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Chapter 7

Federal Laboratories for Human and Animal Health Building Project

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Federal Laboratories for Human and Animal Health Building Project

Main Points

7.1 The new Federal Laboratories for Human and Animal Health in Winnipeg contain some of the most advanced diagnostic, research and training facilities of their kind in the world. The facility is the first in the world to combine laboratories concerned with both human and animal diseases, and the first in Canada capable of handling the most dangerous viruses known. The facility is to be used by Health Canada and the Canadian Food Inspection Agency.

7.2 International experts involved in reviewing the design and construction of the facility have noted that it is extremely secure with regard to containment of biohazardous materials.

7.3 Despite a lengthy history of project proposals by Agriculture and Agri-Food Canada and Health Canada to construct new laboratory facilities, the Winnipeg project was undertaken without adequate analyses of existing laboratory capacity. The Winnipeg facility currently has space that exceeds its planned program needs and the amount approved by Treasury Board, and that has added to a national inventory of surplus laboratory capacity.

7.4 Health Canada and the Canadian Food Inspection Agency have informed us that they recognize the importance of ensuring that the facility is fully used, including the need to explore potential cost-recovery opportunities. To date, however, a comprehensive business plan and strategy for achieving these aims has not been developed.

7.5 In our opinion, the project is approximately 12 months behind schedule and could have been delivered for at least \$5 million to \$10 million less. In addition, the approved project budget of \$141.8 million does not accurately reflect the project's total cost to the taxpayer, currently estimated at \$176 million. The proposed project budget did not identify all project costs, as required by Treasury Board policy.

7.6 We identified several areas where Public Works and Government Services Canada can improve its practices in selecting and managing consultants on future complex projects like this one. We also noted that shared authority and accountability require careful management to mitigate risks of project delays and added costs.

7.7 As we have noted in reviewing other government projects, the current "build [up] to budget" approach, the lack of systemic incentives for seeking cost savings within approved budgets, and the absence of a departmental culture that supports such aims do not encourage the parties to identify and realize potential cost savings.

7.8 The new facility is a potential source of pride for all Canadians as it contributes to the global effort to identify and combat human and animal infectious diseases. Due to the nature of its programs, the Winnipeg laboratories will be expensive to operate and maintain. The challenge for Health Canada and the Canadian Food Inspection Agency will be to ensure that the full potential of this new facility is achieved.

Introduction

7.9 Health Canada and Agriculture and Agri-Food Canada (Agriculture), the two client departments, are jointly constructing world-class laboratories in downtown Winnipeg. Public Works and Government Services Canada (Public Works) is the contracting authority and is responsible for delivering the project. Effective 1 April 1997, Agriculture's portion of the Winnipeg facility was transferred to the Canadian Food Inspection Agency (CFIA), but Agriculture continues to provide project management services to CFIA.

7.10 The new building contains some of the most advanced diagnostic, research and training facilities of their kind in use, and has been described by international experts as a benchmark example for the world. The facility is the first in the world to combine laboratories concerned with both human and animal diseases, and the first in Canada to include laboratories at "biosafety level 4", capable of handling the most dangerous viruses known. Exhibit 7.1 describes the four levels of biosafety and laboratory containment.

Exhibit 7.1

Biosafety and Laboratory Containment Levels

Biosafety level 1

- This level applies to the basic laboratory for the handling of biological agents that are unlikely to cause disease in healthy workers or animals. Biosafety level 1 requires no special design features beyond those suitable for a well-designed and functional laboratory.

Biosafety level 2

- This level is suitable for work with agents that can cause human or animal disease but that, under normal circumstances, are unlikely to be a serious hazard to laboratory workers, the community, livestock, or the environment.

Biosafety level 3

- This level is suitable for work with agents that can cause serious human or animal disease or result in serious economic consequences, but that ordinarily are not spread by casual contact from one individual to another or that can be treated by antimicrobial or antiparasitic agents. The physical and operational requirements of a level 3 laboratory are substantially greater than those for levels 1 and 2.

Biosafety level 4

- This level is for work with agents that can produce very serious human or animal disease that is often untreatable, and that may be readily transmitted from one individual to another or from animal to human or vice versa, directly or indirectly or by casual contact. The physical and operational requirements are highly specialized.
- Biosafety level 4 is the highest level of containment and represents an isolated unit functionally independent of other areas.
- This level of containment requires, for example, an air lock for entry and exit, biological safety cabinets or positive-pressure ventilated suits, a laboratory support area, and a separate ventilation system.

Source: Health Canada Laboratory Biosafety Guidelines, 1996

Program roles for the Winnipeg laboratories

7.11 Health Program. The mission of Health Canada's Health Program is to help Canadians maintain and improve their health. The Laboratory Centre for Disease Control (LCDC) is part of the Department's Health Protection Branch, and, through well-established Canadian public health networks, carries out disease surveillance, risk assessment and control of diseases of national and international importance and concern.

7.12 The Bureau of Microbiology is the primary component of LCDC that is scheduled to move to the new Winnipeg laboratories. The Bureau focusses on a wide range of bacterial, viral and rickettsial pathogens, including hantaviruses, hepatitis, influenza viruses and others. In addition to its new Winnipeg laboratories, the Bureau operates six national centres across the country in collaboration with provincial laboratories, each dealing with a specialized area of microbiology.

7.13 The Winnipeg laboratories are intended to facilitate the Bureau's ongoing work and enhance its ability to manage emerging disease issues, through a network of national and international public health organizations as well as universities and industry partners.

7.14 The Canadian Food Inspection Agency. CFIA delivers inspection and related services that contribute to a safe and wholesome food supply in Canada. Its work also facilitates trade in food and in animal, plant and food products, both interprovincially and internationally.

7.15 The Canadian Food Inspection Agency's National Centre for Foreign Animal Disease (NCFAD) will be located at the Winnipeg laboratories. It focusses on diagnostic testing to identify devastating foreign diseases that could threaten Canadian livestock. NCFAD laboratory personnel are responsible for making initial diagnoses and for training field veterinarians in the early recognition of exotic diseases. NCFAD is also tasked with responding to any foreign disease outbreaks, and it provides analysis and advice for the development of policy on any one of 30 or more exotic diseases that may threaten human and animal health. A 1985 study conducted by Agriculture Canada calculated that an outbreak of foot-and-mouth disease in Canada resulting in an embargo period of 1.5 years would cost the producers an estimated \$2.8 billion in losses.

7.16 In summary, the key program roles of both Health Canada and the Canadian Food Inspection Agency that are to be carried out in the new Winnipeg laboratories include:

- diagnosing human and animal diseases;
- developing new diagnostic methods;
- responding to acute outbreaks of diseases across Canada;
- training federal and provincial scientists and health officials; and
- evaluating methods for controlling and eradicating diseases.

The Winnipeg project

7.17 The new Winnipeg facility comprises approximately 28,300 square metres, including laboratories with biosafety containment levels ranging from 2 to 4. The majority of Health Canada's laboratories require level 2 containment design standards, typical of many laboratories associated with universities, pharmaceutical companies

and hospitals. The majority of CFIA's laboratory space is level 3. Exhibit 7.2 provides details of the facility's space allocations.

Exhibit 7.2

Winnipeg Laboratory Space Allocations

(gross space in square metres)

Space Use	Health Canada	Canadian Food Inspection Agency	Common	Total
Administrative/Office	1,117	410	476	2,003
Circulation	1,605	441	1,572	3,618
Mechanical/Electrical	3,466	1,875	3,797	9,138
Other	476	23	4,682	5,181
Biosafety Level 2	4,596	717	0	5,313
Biosafety Level 3	666	2,110	30	2,806
Biosafety Level 4	181	78	0	259
Total	12,107	5,654	10,557	28,318

Source: Project team, based on design calculations only, accuracy \pm 10 percent

7.18 In addition to the laboratory and office space, the facility includes a 137-person-capacity auditorium for training purposes, common areas such as the cafeteria, the library, service and storage areas, and support infrastructure.

7.19 Approximately 180 staff members are expected to work in the facility when it becomes fully operational in late 1998. A further 45 Public Works staff will operate and maintain the building. At the completion of our field work, 70 positions had not yet been staffed. Senior program officials believe that staffing these positions with the right people is a challenge that must be met to ensure program delivery.

7.20 Project management framework. The departments entered into a Memorandum of Understanding in March 1990 (subsequently revised July 1994 and January 1997), which established an independent project management framework. The framework reflects a two-tier committee structure comprising a Project Steering Committee and several operational committees.

7.21 The Project Steering Committee is responsible for the overall direction and conduct of the project. It currently comprises five assistant deputy ministers - two from Health Canada, and one each from Agriculture, the Canadian Food Inspection Agency and Public Works. The Chair alternates between the two client departments. Day-to-day management of the project is carried out through the Client Management Committee and the Project Management Committee. The Client Management Committee comprises senior officials from the program areas of the two client departments and their facilities management officials. The Project Management Committee consists mainly of the project managers and other project staff of the two client departments and is chaired by the Public Works project manager.

7.22 Project budget and schedule. The approved project budget for the Winnipeg facility is \$141.8 million, funded about equally by Health Canada and Agriculture. Annual operating and maintenance costs are estimated at \$9.0 million, funded on a 70 percent/30 percent split between Health Canada and Agriculture. The identified project schedule when Treasury Board granted effective project approval in August 1992 is shown in Exhibit 7.3. Actual and projected dates are also shown. Exhibit 7.4 presents a chronology of key events leading to the approval of the Winnipeg facility project.

Exhibit 7.3

Project Milestones

Activity	Planned	Actual or Projected
Project Brief	November 1990	June 1991
Design	January 1993	May 1993
Construction Complete	March 1996	Interim Certificate of Completion issued 24 October 1997. Final Certificate of Completion expected to be issued by June 1998.
Commissioning/ Testing	June 1997	Commissioning is being carried out in phases and is expected to be completed by April 1998.
Move-in	June 1997	The Canadian Food Inspection Agency began to move in October 1997 and expects to be fully operational in the spring of 1998. Health Canada is planning to move in during spring/summer 1998. Level 4 laboratories could be ready for operations by fall 1998.

Source: Joint Health and Welfare Canada — Agriculture Canada Treasury Board Submission, August 1992

Exhibit 7.4

Chronology of Key Events Leading to the Winnipeg Project

27 May 1975	Treasury Board (TB) approved in principle the construction of a new Animal Virus Laboratory (AVL) as part of Agriculture's long-range construction program.
7 February 1980	TB approved in principle the construction of the AVL in Ottawa, at a cost not to exceed \$36.4 million. The project was to be completed by 1984-85.
March 1982	TB approved Health Canada's request to develop a construction/renovation program to improve occupational health and safety in the Health Protection Branch.
20 September 1982	TB authorized Public Works to engage design consultants to produce a class "B" control budget for the AVL project. Construction costs estimated at \$52.7 million.
January 1984	Consultant report on Health Canada's virus laboratory recommended constructing new facilities to house the Bureaus of Microbiology and Biologics, at an estimated cost of \$52.4 million. Construction and occupancy to be completed by July 1990.

5 December 1985	TB gave preliminary project approval for the construction of a new Health Canada virus research building in Ottawa, at an estimated cost of \$93.2 million.
October 1986	Revised cost estimates for the AVL project increased to \$92.9 million. Agriculture asked TB to withhold construction approval for three years until it was able to review its program and laboratory design requirements.
December 1986	As part of the government's restraint program, TB withdrew funding of \$52.3 million for the AVL project to be built on the Woodroffe Campus.
30 January 1987	Public Works issued a proposal call for consulting services for the LCDC and the Bureau of Biologics project to be built in the National Capital Region. Construction costs estimated at \$80 million and project scheduled to be completed and commissioned by September 1993.
22 June 1987	Meeting between Agriculture and Health Canada to discuss the feasibility of undertaking a joint project in Winnipeg.
30 June 1987	Minister of Public Works approved the prime consultant to design the LCDC and Bureau of Biologics Ottawa project.
September 1987	Minister of Health announced that the \$93.2 million LCDC project was being transferred to Winnipeg.
17 December 1987	TB approved \$93.2 million for the new Health Canada LCDC building in Ottawa and the microbiology laboratory in Winnipeg. Health Canada was asked to review the cost estimates for these two laboratories, seek TB approval for the change in scope of the LCDC project, and seek preliminary project approval for the microbiology laboratory. TB stressed that the total costs for the two buildings should not exceed \$93.2 million.
3 May 1988	Health Canada and Agriculture requested Public Works to develop jointly two laboratory facilities, one in Winnipeg and one in Ottawa, on an accelerated basis at an estimated total cost of \$120 million to \$130 million.

Source: Health Canada and Agriculture and Agri-Food Canada

Focus of our audit

7.23 We examined the major aspects of the design and construction of this major Crown project from the perspective of the generally accepted phases of good project planning and implementation. Because of the nature of the work that will be carried out in the facility, we were particularly interested in assessing whether appropriate measures were taken to ensure employee and community safety. Our interest in Health Canada, Agriculture and Canadian Food Inspection Agency program issues was limited to obtaining a general understanding of the program requirements that the new laboratories were designed to meet.

7.24 Health Canada has also recently constructed new laboratory facilities at its Tunney's Pasture campus in Ottawa. The Winnipeg and Ottawa projects were initially planned and managed as one, but were subsequently separated and treated as two distinct projects. Our audit focussed on the Winnipeg project. Further details on audit objectives, criteria, scope and approach can be found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

7.25 While we consider all aspects of delivering a major Crown project to be important, we believe that meeting the functional and safety requirements for the Winnipeg laboratories is the most critical aspect of this project for the general public, the scientists and staff employed in the new facility and residents of the surrounding community in Winnipeg.

Biosafety

Appropriate measures taken to ensure employee and community safety

7.26 Biosafety is an abbreviation of “biological safety” and is concerned with the maintenance, safe handling and containment of micro-organisms that are infectious to either humans or animals or both.

7.27 We are satisfied that issues affecting employee and community safety have been of primary concern throughout the project. An extensive commissioning process has been used to ensure that all biosafety requirements are met. International experts involved in reviewing the design and construction of the facility have noted that it is extremely secure with regard to containment of biohazardous materials. In January 1996, the appropriate program and project officials prepared a document that demonstrated that the facility met, and in some cases exceeded, the laboratory biosafety guidelines issued by Health Canada and the Medical Research Council of Canada. Officials are planning to update that study, and they advise us that biosafety experts will sign off the results of all relevant commissioning tests to ensure that the constructed facility meets the appropriate standards.

7.28 Since the inception of the project, the project team has been committed to ensuring that the public has had the opportunity to comment at each major step of the project’s development. A September 1997 public consultation report, commissioned by the project team, concluded that the public consultation process has resulted in a positive relationship with the community, which generally continues to be supportive of the facility.

Roles and reporting relationships need to be strengthened

7.29 Health Canada’s Office of Biosafety was formed in 1980 to collect, review, store, and disseminate up-to-date information on the safe design, construction and operation of laboratories in Canada. The Office’s main functions are to provide consultative services on request to microbiology laboratories in hospitals, universities, public health laboratories and research facilities. This includes assistance with problems in safety operations as well as total-facility evaluations. The Office was instrumental in developing and updating the laboratory biosafety guidelines. The Director of the Office of Biosafety now reports to the Director of the Bureau of Microbiology and, we are advised, will soon report to the Director General, LCDC.

7.30 In 1992, the Treasury Board Guide on Occupational Safety and Health was revised to encourage all microbiological laboratories of the federal government to conform to Health Canada’s Laboratory Biosafety Guidelines. We note, however, that the Treasury Board guidelines do not contain any provision for monitoring compliance with the guidelines. The decision to involve the Office of Biosafety during the design, construction or operation of a laboratory facility is at the discretion of departmental managers.

7.31 The Biohazard Containment and Safety Unit of Agriculture and Agri-Food Canada was originally formed in 1993 to provide containment and biosafety services to the Animal and Plant Health Directorate. In 1997, this unit joined the Science Advisory and Management Division of the Canadian Food Inspection Agency. The Director of the Division reports to the Director General, Animal and Plant Health, who in turn reports to CFIA’s Vice-President of Programs.

7.32 The Unit provides direction to CFIA staff on containment of animal pathogens and biosafety practices. It establishes standards for containment facilities handling animal pathogens and determines the appropriate containment level for each animal pathogen under CFIA control. Under an internal certification program, the Unit ensures that the CFIA facilities meet the physical requirements and operational practices outlined in the Containment Standards for Veterinary Facilities. The Unit also supports the Animal Health Division’s import program by certifying all facilities in Canada wishing to import or transfer an animal pathogen.

7.33 We noted that the roles and responsibilities of the Biosafety Branch of the U.S. Centers for Disease Control and Prevention (CDC) are more formalized and that the Biosafety Branch enjoys greater independence than its Canadian counterpart, reporting to the Deputy Director of CDC. The Branch is involved at all stages of design, construction, renovation, maintenance and repair of CDC laboratories at biosafety levels 2, 3, and 4, and it formally certifies laboratories before they begin to operate. On a request basis, the Branch is also consulted concerning the safe design and operation of similar laboratories in the public and non-profit domains within and outside the U.S. A recent U.S. federal regulation requires government, university and industry laboratories working with certain infectious agents to register with CDC. We were advised that registered laboratories are periodically inspected by CDC and that the responsibility for managing the regulation rests with the Biosafety Branch.

7.34 We believe that the roles and responsibilities of the Office of Biosafety and the Biohazard Containment and Safety Unit need to be strengthened. In our view, there is a need for these specialists to systematically review all laboratories dealing with infectious agents and to formally attest that the relevant biosafety guidelines are being followed. We believe this is particularly appropriate at a time when Canada is embarking on working with the most dangerous viruses known, and has the potential for future program expansions. We also believe that the reporting relationship of the biosafety offices needs to be independent of program managers in order to minimize any real or perceived conflict of interest.

7.35 **Health Canada and the Canadian Food Inspection Agency should review the roles and reporting relationships of the Office of Biosafety and the Biohazard Containment and Safety Unit respectively with a view to strengthening them and to minimizing any real or perceived conflict of interest.**

Health Canada and Canadian Food Inspection Agency response: Agreed. Health Canada and the Canadian Food Inspection Agency will be reviewing the role and reporting relationship of the Office of Biosafety and the Biohazard Containment and Safety Unit, respectively, to examine the most effective way to deliver their services. Health Canada, subject to the will of Parliament and in the context of the Health Protection legislative renewal exercise, will examine the issue of the manipulation of human pathogens to determine whether additional legislative controls should be in place at the federal level.

Needs Definition and Options Analysis

Decision to construct new facilities was taken without analyzing existing capacity

7.36 Documentation of the need for new laboratory facilities for Agriculture and Agri-Food Canada dates back to 1975 (see Exhibit 7.4) and earlier, and for Health Canada to 1982. Various plans and projects to replace and augment existing facilities were established and then deferred or abandoned, sometimes at a significant cost to the taxpayer. The most recent example was the October 1986 cancellation of a new Animal Virus Laboratory slated to be built in Nepean, Ontario. That project was cancelled because the estimated cost had increased from around \$52 million to about \$93 million. By the time the project was cancelled, however, approximately \$5.5 million had already been spent on plans and specifications.

7.37 The Winnipeg project was formally initiated in September 1987. The justification presented to the Treasury Board by the two client departments for new facilities, including the requirement for high-containment level 4 facilities, was based on the following rationale:

- existing facilities were inadequate;
- programs undertaken were limited because existing facilities could not provide the necessary containment control;

- an outbreak of a major exotic animal disease could have major economic ramifications in terms of lost trade;
- there had been an increase in and re-emergence of global infectious diseases; and
- the possibility of contracting out the departmental requirements would not be a viable option.

7.38 Our audit confirmed that both departments needed to upgrade and augment existing facilities in order to carry out their mandated programs efficiently and effectively. Part of the new facilities in Winnipeg addressed a capacity and program need that could not be met in any laboratories in Canada. However, at the time the decision was made to construct the new facilities in Winnipeg, an in-depth analysis of each department's overall laboratory profile and capacity to meet current and future needs had not been conducted. It was not until April 1996 that Health Canada commissioned a study to assess the Department's current and future needs for laboratory services and facilities. The new federal laboratories in Winnipeg are considered a keystone of Health Canada's microbiological laboratory services and capacity and were not included in the study analysis.

7.39 The Health Canada study concluded, in part, that the Department was spending significant amounts of maintenance dollars on what appeared to excess laboratory capacity, and recommended that a laboratory space optimization study be carried out. Health Canada officials acknowledge that there was a tendency in the past to intentionally overbuild capacity in anticipation of future growth to manage unexpected contingencies, which often did not materialize.

7.40 Health Canada has another laboratory facility in Winnipeg. The two-storey building, completed in October 1987 at a cost of approximately \$12 million, comprises a total gross area of over 5,900 square metres. We observed that the facility was being underused, and were advised by Health Canada that the excess space is due to planned overcapacity for future growth that did not materialize because of government downsizing and consolidation of programs. We also noted that the facility includes a containment laboratory that has never been commissioned or operated, or evaluated for its potential to meet part of the program needs being transferred to Winnipeg.

7.41 In July 1997, the Canadian Food Inspection Agency established a task force to assess the future level of laboratory and quarantine support service it requires. The objective is to develop options for reducing the cost of laboratories and quarantine inspection with minimal impact on service. CFIA informed us that the study had not been completed by the end of our field work, and that the scope had been enlarged to include a broader consideration of options. It is not yet clear when the study will be completed.

7.42 **Health Canada and the Canadian Food Inspection Agency should include the capacity of the Winnipeg laboratories in their ongoing assessments of their national laboratory requirements.**

Health Canada and Canadian Food Inspection Agency response: Agreed.

Constructed space exceeds approval and requirement, with no strategy to optimize use

7.43 In our opinion, the new Winnipeg facility can accommodate significantly more than the number of scientists and support staff planned for occupancy. We noted several facts that would indicate that the constructed net space has increased and that surplus capacity now exists.

7.44 In seeking additional project funding in May 1991, the client departments assured Treasury Board that they had reviewed their programs and eliminated all unnecessary redundancies. The total space requirements at that time were stated as 10,900 net square metres. When seeking effective project approval in August 1992, the total space requirement had grown to 12,200 net square metres, without a corresponding increase in program requirements. The constructed net space, as listed by the prime consultant in May 1996 in a marketing brochure, totalled 13,000 net

square metres, representing increases of approximately 20 percent over the initial requirement and 7 percent over the revised requirement.

7.45 The project brief, dated June 1991, states that the total net area of 3,600 square metres of existing Agriculture laboratories and cubicles in Hull, Quebec would be accommodated in 2,568 square metres net space assigned to the Department in the Winnipeg facility. However, the brief notes that Health Canada's Bureau of Microbiology, currently occupying 2,500 square metres in four buildings at Tunney's Pasture in Ottawa, will be replaced by 5,610 square metres of net area in the Winnipeg facility, more than double the space. A consultant's review of the brief, commissioned by Health Canada, noted that the Winnipeg facility would provide Health Canada staff with about double the amount of space provided to their American counterparts at CDC.

7.46 In a letter to Health Canada dated October 1996, an expert from the World Health Organization serving on the Winnipeg project's Blue Ribbon Review Committee noted that the facility could probably hold two to three times the number of scientists and support staff now planned for occupancy. Furthermore, a senior CFIA program manager noted that under certain scenarios its portion of the facility could accommodate more people than currently planned for occupancy.

7.47 On a national basis and excluding the Winnipeg facility, Health Canada's total functional laboratory space utilization ranges from 27 to 86 square metres per professional scientific staff member, with a program average of 54 square metres. The Winnipeg facility has about 100 square metres per professional scientific staff member, or about double the size. It also has more than double the amount of space per staff member in the recently constructed wing of the LCDC facility in Ottawa.

7.48 Both departments have informed us that they recognize the importance of ensuring the full use of the Winnipeg facility's capacity, including the need to explore potential cost-recovery opportunities. At the end of our field work, however, a comprehensive business plan and strategy for achieving these aims had not yet been developed.

7.49 **Health Canada and the Canadian Food Inspection Agency should conduct a space utilization study of the new Winnipeg facility to determine how much surplus space is available. A comprehensive business plan and strategy should be developed for the facility to ensure that its capacity is fully utilized and to explore potential cost-recovery opportunities.**

Health Canada and Canadian Food Inspection Agency response: Agreed.

Inadequate analysis and implementation of options results in unproductive payment and higher costs

7.50 We noted several options for cost savings that were not implemented in a timely manner or were not adequately explored by the project team. For example, when it became apparent in 1991 that the cost of the combined Ottawa and Winnipeg projects would significantly exceed the approved budget, the project team decided to retrofit and expand an existing facility in Ottawa rather than constructing a new stand-alone facility as then proposed. It was estimated that this retrofit option would save approximately \$10 million without affecting program delivery. In our opinion, the viable retrofit option should have been considered earlier in the planning process, even in the absence of a budget limitation. If this had been done, the project would have benefited from the estimated \$10 million saving at the outset, and would also have avoided approximately \$2 million paid in fees and expenses for abandoned work on the stand-alone option.

7.51 In 1993, one member of the project team became concerned that the project risked going over budget by approximately \$15 million. He identified, and reported to a senior departmental official, several cost-saving options that he believed would not impact program delivery. The proposed cost-saving measures consisted of reducing the amount of Health Canada laboratory space, modifying some architectural features and eliminating the auditorium.

The rest of the project team, however, did not share the view that the project was over budget and did not support the proposed cost-saving measures. In our view, these potential cost savings were of a nature and significance to warrant a formal review and consideration by the Project Steering Committee.

Financial Management and Control

7.52 Realistic budgets, sound cost control measures and accurate and timely reporting underpin a good financial management and control framework. For the system to work properly, budget estimates need to be reviewed rigorously and challenged by senior managers and Treasury Board officials when approving projects, to ensure that the project is sufficiently funded and to safeguard against approving funds in excess of need. The approved budget provides a yardstick against which the project's financial progress can be measured. Accurate and timely reporting of actual compared with budgeted costs allows decision makers to address any significant variance or exception. In our opinion, stronger financial management and control were needed on the Winnipeg project.

Preliminary project budget was incomplete and subsequent increases not well supported

7.53 In January 1989, Health Canada and Agriculture prepared a joint submission to Treasury Board requesting preliminary project approval to develop a project for \$145 million, of which \$93.9 million related to the joint Health Canada and Agriculture project in Winnipeg and \$51.1 million to Health Canada's Disease Control Centre in Ottawa. The departments advised Treasury Board that the \$145 million budget included resources to completely fit up both centres to provide turn-key operations. We noted, however, that Public Works believed a more realistic budget of approximately \$173 million was required to deliver the project and, accordingly, did not endorse the Treasury Board submission. Public Works officials informed Treasury Board Secretariat officials of the higher cost estimate, but this information was not reported in the Treasury Board submission.

7.54 In June 1989, Treasury Board granted preliminary project approval on the condition that preparation of final design documents was not to proceed until it could be assured that projected costs would not exceed \$145 million. In May 1991, after it became apparent that the project could not be delivered within the approved budget, a revised budget of \$183.5 million was requested, of which \$141.8 million would be for the Winnipeg facility. The departments explained that the increased costs were due to inflation, GST, contingencies, site development costs and project management and consultant costs, and attributed 50 percent of the cost increase directly to inflation and the GST.

7.55 We did an analysis of the impact on the project budget of inflation and the introduction of the GST. According to Statistics Canada data, there was actually a slight decrease in inflation (in the non-residential building construction price indexes) between 1989 and 1991. With respect to the GST, we calculated the impact (net of the Manufacturing Sales Tax) to be less than 10 percent of the cost increase. Therefore, we conclude that the combined impact of these two factors accounted for less than 10 percent of the increase and that Treasury Board was not provided with an accurate explanation for the project cost increases.

Approved project budget does not accurately reflect total project costs

7.56 In August 1992, Treasury Board approved the \$141.8 million budget requested for the Winnipeg facility. We found that the precise nature and extent of activities intended to be financed by the budget were not made clear.

7.57 We were informed that the two departments adopted different philosophies in preparing their respective budgets. For example, the project budget included a total of about \$10.5 million for staff relocation costs, client disbursements and equipment. Agriculture's budget included \$5.8 million for equipment purchases, whereas Health Canada identified only \$650,000 within the project budget and is now funding about \$9.3 million internally for its equipment. Health Canada is also funding an additional \$9.6 million from non-budget resources to relocate affected

personnel, whereas Agriculture is funding these costs from its share of the \$141.8 million project budget. We also found that the departments spent an additional \$9 million from non-project funds to administer the project. Exhibit 7.5 provides a more realistic total cost to construct and operate the facility.

Exhibit 7.5

Estimated Total Project Costs

One-Time Costs	(\$ millions)	Ongoing Costs	(\$ millions)
Construction	101.4 *	Operations and Maintenance	9.0
Equipment	25.2	Incremental Resources for Scientific Program	4.0
Consultants	21.6	Grants in Lieu of Taxes	2.2
Staff Relocation	10.6		
Administration	9.0		
Public Works	8.2		
Total	176.0	Total	15.2

* Includes \$4.9 million settlement by Public Works of the general contractor's delay claim. The resulting increase in the approved project budget remains subject to Treasury Board approval.

Source: Health Canada and the Canadian Food Inspection Agency

7.58 In our opinion, at the effective project approval stage, Treasury Board was not provided with a clear and comprehensive estimate of the project's total cost, which is currently approximately \$34 million in excess of the approved budget of \$141.8 million. As a result, ministers approved the project without having a realistic and complete picture of how much the facility would cost the Canadian taxpayer.

Project team philosophy of “build [up] to budget” provided no incentives for cost savings

7.59 Similar to most other major Crown projects we have examined, the project team followed a “build [up] to budget” philosophy for project development purposes. While this approach aims to ensure that the overall budget is not exceeded, it provides no incentives to pursue potential cost savings and deliver a project below budget where possible. The project team is ultimately accountable only for staying within the total Treasury Board-approved budget, regardless of whether the budget eventually proves to be in excess of need. For instance, there are many estimates for contingencies built into the approved budget that may not be required, but they are not accounted for and reported separately to ensure their cost-effective use. Design reserves, contract contingencies, inflation and risk allowances represent large pools of funds that we believe need to be approved, tracked and accounted for separately from the base budget.

7.60 Public Works officials acknowledged the reality that many projects are designed to budget. They believe that this approach should be changed, but that this will require a change in culture. Public Works is currently looking at how fees are identified and paid, and at what stages in the contract they are paid. It believes that contracts must be structured in a way that provides incentives for cost savings. The contracts for this project do not provide incentives to the consultants to reduce costs, as their fees were based on a percentage of the construction costs. We support Public Works' efforts to reform its contracting practices with a view to providing incentives for identifying potential cost savings and delivering projects below budget where possible. However, Public Works officials

acknowledge that appropriate controls need to be in place to ensure that cost savings are not achieved at the expense of program delivery and do not result in increasing the total life cycle cost of the project.

7.61 The Treasury Board Secretariat should clarify the precise nature and extent of activities that approved project budgets are intended to finance. The Secretariat and departments should also stress the achievement of best value in procurement decisions and develop incentives to encourage underspending of budgets where possible.

Treasury Board Secretariat response: The Treasury Board policy regarding project approvals includes a cost objective, an estimate of the total resources to be approved by the Treasury Board and needed to implement the project. It has been and will continue to be an objective of the Treasury Board review of departmental submissions to ensure that departments have included all costs to implement the project in the budget approval sought.

The objective of the Treasury Board policy on 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.”

The Treasury Board Secretariat shall focus more on options to achieve cost savings within the overall budget when reviewing departmental submissions. For departments and agencies with capital budgets, affordability should drive their investment strategies and value for money should be ingrained into their management philosophy.

The Secretariat does not believe that an incentive regime at the project level to encourage underspending of budgets would be an effective way to achieve savings. It would be difficult to envision an incentive regime that would not have a potential downside in the absence of a much more rigorous Treasury Board approval process than presently exists. For example, the Secretariat would be concerned that an incentive to share savings would lead to increased pressure to pad cost estimates and upscale design requirements, thereby increasing the potential to come in under budget by seeming to cut costs and generate design savings.

7.62 Public Works and Government Services Canada should revise its contracting practices to provide incentives for cost savings within approved budgets but without compromising project objectives. The Department should also ensure that the design reserves, contract contingencies, and inflation and risk allowances are approved, tracked and accounted for separately from the base budget.

Public Works and Government Services Canada response: Agreed. Public Works and Government Services Canada is currently identifying ways to introduce into the overall contracting process viable and meaningful incentives for reducing costs where feasible. Public Works will develop best practices and consider the workability of formalizing the reporting of changes in design reserves and contract contingencies.

Improved reporting of budget variances is required

7.63 An internal audit of the Winnipeg facility found, and our own work confirmed, that the budget components and amounts were often reallocated within the approved budget. Moreover, we noted that actual costs were not reported in the same format as the project budget. While we recognize that budget funds need to be reallocated as more information becomes available, we believe that the source, justification and approval of these changes should be clear and well documented. For example, we noted that consultant cost increases totalling \$10.2 million were financed from within the approved budget, but it is not clear which budget elements generated the savings to finance those increases.

7.64 We noted that the project management team did not use a formal forecasting methodology to estimate potential future cost increases. It believed that because of the project’s unique and complex nature, formal forecasting could not be implemented as a cost-effective and reliable management tool. In our opinion, the

forecasting technique used by the project team was not adequate to address variances in budget and schedule. We noted that as early as 1996, the project team was reporting to deputy ministers and ministers that the project was ahead of schedule and on budget, while in our opinion it was at serious risk of being behind schedule and going over budget.

Non-compliance with Treasury Board policies

7.65 We noted several instances where Public Works had exceeded its spending authority and Treasury Board approval was granted retroactively. In one instance, we found that in June 1996 Public Works had exceeded Treasury Board payment authority by approximately \$500,000 before it realized its mistake. However, when seeking additional payment authority, the Department did not inform the Board that payments had already been made against the additional spending authority it was seeking.

7.66 We also noted a lack of project progress reporting and inadequate reporting of project costs to Treasury Board. We are concerned with the lack of semi-annual reporting on the progress of a major Crown project, as required under Treasury Board policies. Our main concern, however, is the accuracy and completeness of statements in various Treasury Board submissions, such as those justifying project cost increases; they appear to be inconsistent with our audit evidence.

7.67 **The Treasury Board Secretariat should ensure that departments submit project progress reports as required by Treasury Board policies on the management of major Crown projects.**

Treasury Board Secretariat response: The Treasury Board Secretariat supports this recommendation. While an earlier policy required semi-annual progress reporting, it has since been revised to require reporting at pre-defined key milestones of a project. This would result in better reporting. Ultimately, responsible departments and ministers are accountable for the work to be performed and the expected results to be achieved in a manner consistent with the policy and the Treasury Board approval. Corrections and adjustments to plans may be necessary along the way. In situations where authorities need to be adjusted, departments are responsible for pursuing corrective action and seeking necessary Treasury Board approvals.

Project Management and Control Framework

Two internal audits identified concerns about early project management practices

7.68 A private sector firm, commissioned by the two client departments, completed two internal audits of the Winnipeg project and issued reports in November 1992 and June 1996. Both reports focussed on the appropriateness of the project's management and control framework.

7.69 The first report recommended, among other things, improving budgeting practices, defining and controlling contingency reserves, and strengthening the design review process. The report also noted the lack of incentives to reduce costs below the Treasury Board-approved budget.

7.70 The second report followed up on the status of recommendations raised in the first report and noted that the majority of them had been addressed only partially or not at all. It recommended that the project team demonstrate that Health Canada's Laboratory Biosafety Guidelines had been incorporated into the design of the new facility and that the presence of the client departments' expertise on site be consistent with the importance of the construction activities to follow. The report also noted that there were no agreed, realistic construction schedule and commissioning monitoring plan, and that the construction monitoring and verification agreement was based on an

unapproved construction schedule. The report reiterated the recommendation to improve budgeting, forecasting and reporting practices.

7.71 We found that management had fully addressed the recommendation to demonstrate the linkage of the design to the biosafety guidelines, and had addressed to various degrees many of the other recommendations. Some recommendations were deemed retrospective and not useful to completing the project.

Consultant selection and management practices require improvement to mitigate risks of increased costs

7.72 In December 1986, the Minister of Public Works approved a list of seven firms to submit proposals to program and design a new high-containment laboratory and office building for Health Canada in the National Capital Region. The facility would accommodate the LCDC and the Bureau of Biologics. In May 1987, proposals from all seven firms were formally evaluated by a Public Works committee and a winning proposal was selected. We were not able to review the evaluation committee's ranking of the proposals because the documentation was no longer available.

7.73 In September 1987, before the contract was formally awarded, a decision was made to move part of Health Canada's project to Winnipeg, Manitoba. It was also decided that Agriculture's requirement for a new virus laboratory, originally planned for Nepean, Ontario, would be included in the new Winnipeg facility. Some project officials believed that these decisions had significantly changed the scope of the project. They were concerned that the appointment of the original contractor, selected for a fundamentally different project, could be seen as undermining the fairness of the consultant selection process. Other officials believed that despite the change in project scope and cost, the overall intent of the new project was similar to the original project; any recall of proposals would be time-consuming and would increase costs to both the Crown and the consultants involved.

7.74 Given the nature and magnitude of the scope change, and the high risk that awarding the contract on the basis of a fundamentally different project could be seen as compromising the fairness of the consultant selection process, we believe the Project Steering Committee did not sufficiently justify the decision not to retender the commission.

7.75 For large and complex projects such as the Winnipeg project, we would have expected the consultant agreements to be tailored to take into account contractual issues specific to the project. Instead we found that, consistent with its policy at that time, Public Works used its standard departmental consultant agreement, developed for the "normal" situation of a smaller project managed by a consultant from one office with subconsultants of its choice, usually in close proximity to the prime consultants. Throughout the project there were contract disputes between Public Works and the prime consultants, and at times with subconsultants, over issues that had not been set out clearly in the consultant agreement and that resulted in additional costs. Examples included:

- lack of definition of what constituted the approved construction cost estimate on which the consultant fees were based;
- unclear methodology to calculate consulting fees on contingency fund items;
- lack of definition of what constituted design errors and omissions;
- interpretation of the clauses on travel time and consultant location; and
- interpretation of whether certain fees were based on the contractor's unapproved shorter schedule or on the schedule set out in the contract.

7.76 Exhibit 7.5 details the estimated project costs. The cost of consulting services, including Public Works fees and departments' administration costs, totalled \$38.8 million. We believe that these costs are high, as they represent about 38 percent of construction costs or 31 percent of the combined construction and equipment costs. Project officials agree that the costs are higher than expected and attribute the increase to several factors. Programming and construction delays required more on-site personnel for longer periods than planned. Extensive travel was required by a great many consultants and project staff, from offices in six cities across the country. The decision by Health Canada to hire separate consultants to review the work of the prime consultants also added significantly to the costs of consulting services.

7.77 In our view, several million dollars could have been saved by:

- locating full-time project staff in Winnipeg;
- eliminating the need to hire additional consultants to review the work of the prime consultants; and
- strengthening contractual agreements to take into account contractual issues specific to the project.

7.78 Public Works and Government Services Canada should ensure that consultant contracts are tailored to the specific project, and should improve its monitoring of contractor performance.

Public Works and Government Services Canada response: Since 1993, PWGSC has adopted a new standard by substantially revising the consultant's contract form in consultation and co-operation with professional associations. These contracts are tailored to different types of work, consistent with professional standards, while allowing the flexibility to individualize the scope of the work to adapt to the specifics of the project. PWGSC continues to review the standard consultant agreement to allow further tailoring to specific project circumstances.

Project governance, team "chemistry" and turnover rates adversely affected project delivery

7.79 A key ingredient for success is the establishment of a focal point for leadership with appropriate authority and accountability, at the beginning and throughout a project. Multi-department projects require participants to accept that they are a team working for the achievement of overall government objectives. Trust and respect for individual roles and responsibilities are necessary for team building.

7.80 We found that the management and control framework and practices contributed, in part, to the project team's inability to prevent or to resolve more effectively some of the problems experienced on the project, including cost overruns and construction delays. The decision-making process was made more difficult and complex on this project because there were two client departments whose program requirements and preferred options frequently did not coincide. This often led to negotiation and debate before agreement to proceed was reached.

7.81 We noted several instances where the client departments had difficulty agreeing on how best to resolve problems; in the early stages, lack of teamwork among project staff was the pervasive working environment. Exhibit 7.6 provides one example of difficulties encountered in reaching consensus, in this case deciding on the most appropriate autoclave (sterilizer) unit. We also noted, however, that teamwork and co-operation improved significantly from mid-1995, when Health Canada reorganized its project management staff and approach.

Exhibit 7.6

Case Study - Autoclaves

In 1992 the autoclave (sterilizer) requirements and specifications were the subject of many meetings and reviews by the project staff, including the prime consultants. In the tender documents issued in May 1993, two firms were identified as acceptable sources of

autoclaves. The general contractor's bid included Firm A as its subcontractor for autoclaves. However, in January 1994 Firm B protested to Public Works that it should have been awarded the subcontract, alleging that Firm A's equipment did not meet the contract specifications.

In April 1994, the consultants providing separate advice to Health Canada throughout the project issued a report detailing concerns about the decision to use Firm A's equipment, stating that the Firm A autoclaves did not meet the essential criteria for laboratories at biosafety levels 3 and 4.

The prime consultants complained that they were spending an excessive amount of time responding to false accusations and innuendo about the Firm A equipment, and that for two years they had been unable to get Health Canada to specify which features were required on the autoclaves. They also noted that the specifications were written to allow for the two autoclaves to compete on an equal basis, as requested by the client departments, and that despite all the concerns, Health Canada had yet to issue a formal request to have Firm B's equipment supplied.

Public Works advised the client departments that the prime consultants had reviewed the shop drawings for Firm A's equipment and concluded that it did meet the specifications. Public Works requested that Health Canada acknowledge the following:

- Rejection of the Firm A equipment was a Health Canada requirement to meet safety concerns, and the Firm B equipment constituted a sole source to meet these requirements.
- Firm A might claim for losses since its equipment had initially been identified as acceptable, and these costs would have to be borne by Health Canada.
- Only autoclaves in Health Canada's space would be supplied from Firm B.

Health Canada never formally responded to this request.

The Public Works project manager sought direction from the Project Steering Committee to resolve the difference of opinion between Health Canada and the prime consultants. The Project Steering Committee decided in favour of the original contractor (Firm A). The net result of these events was to create acrimony among the project team and delays in arriving at a consensus.

7.82 The prime consultants noted that there were divergent viewpoints among the client departments and Public Works on matters of project scope, design and operations. In our view, the project began without a sense of commitment by all parties, which often manifested itself in disagreements and lack of teamwork.

7.83 Although Public Works is the contracting authority responsible for delivering the project, Health Canada felt the need to spend \$1.6 million on a separate consultant to review the project brief, design documents and contemplated change notices. The situation frustrated Agriculture, Public Works and the prime consultants because it slowed progress and created an atmosphere of second-guessing matters for which the separate consultant was not ultimately responsible. We were informed that very few of the recommendations from the separate consultant had been implemented in the project.

7.84 The Project Steering Committee was responsible for the overall direction and conduct of the project. At the outset, it comprised three assistant deputy ministers, one from each of Health Canada, Agriculture and Public Works. In July 1995, the Committee was enlarged to five assistant deputy ministers, two from Health Canada and one each from Agriculture, the Canadian Food Inspection Agency and Public Works, to better reflect facility management issues. We noted that, over the life of the project, 13 different members have served on the Committee for terms of two to three years each. In our view, the high turnover rate and the need to make decisions by consensus diffused project accountability. We believe that this lack of continuity and accountability in the management and control framework contributed at least in part to the inadequate defining of project cost and construction schedule, and to the number and large dollar values of claims on this project.

7.85 In future projects with more than one client department, the Treasury Board Secretariat should ensure that a single authority is established as the lead authority to represent the interests of all client departments and to be held accountable for the project results, as intended in the Treasury Board policies for managing capital projects.

Treasury Board Secretariat response: The Treasury Board policy intends that a single authority be established for management and accountability purposes. Complex organization structures and joint ventures may require steering committees to ensure that the interest of multiple parties are considered during the conduct of large projects. In these situations, dispute mechanisms may be put in place to assist in the resolution of disputes and facilitate the efficient and effective conduct of the project by the lead authority.

Health Canada, Agriculture and Agri-Food Canada, Public Works and Government Services Canada and Canadian Food Inspection Agency response: It is the view of the three departments and Agency that Canadians can be proud of this world-class facility, which reinforces Canada's established reputation as a leader in science and will put Canada at the forefront of human and animal health. The project management team successfully responded to the significant challenges of managing a highly complex and unique project over a ten-year period that included the planning and solution required to accommodate three building code upgrades; the need to satisfy all levels of government approvals; adapting to not only staff turnover but significant organizational changes at the departmental level; evolving programs; and rapid advances in technology.

Better management of change orders would have reduced costs to the Crown

7.86 As with any complex project, adjustments were made to the plans, specifications and contracts in place. These changes were implemented through the mechanism of contemplated change notices and change orders; an approved change notice becomes a change order. Work carried out through change orders is usually more expensive because it is not subject to competitive bidding, and it generates significant administrative markups when multiple suppliers are involved. Contract changes also increase the risk that additional costs will be incurred in the form of delay claims.

7.87 We noted that change orders were funded from two sources, a contingency fund of \$7.2 million and a cash allowance of \$12.2 million. The cash allowance formed part of the general contractor's contract and was intended to purchase certain items that were known to be required but for which actual detailed requirements could not be determined prior to the contract award, such as laboratory casework and equipment and controls. Thirty-one change orders totalling \$10.5 million were issued against the cash allowance. For contract changes financed from the contingency fund, 926 change notices were raised, of which 677 were issued as change orders, costing \$7.6 million; 179 were cancelled and 70 remain to be resolved.

7.88 We found that change orders were generally well administered; they were well documented, logged and controlled and the performance of the work was verified prior to payment. However, many of the change orders were poorly managed. Many of the contemplated change notices took a long time to be approved as change orders; several took over 10 months and two took 22 months to resolve. In some instances, we noted that changes in the specifications contributed to the delay in approving the contract changes and resulted in added costs. In many other cases, delays were due to the large difference between the price estimated by the prime consultants and the price quoted by the general contractor, differences that in our sample averaged 330 percent with two cases over 2300 percent.

7.89 Delays and changes also led to unproductive payments. In one case, delays in obtaining client approvals resulted in "bioseal" doors costing \$148,000 more than originally quoted. In another case, disagreements between the clients over whether some autoclave units needed to be modified resulted in \$71,000 in additional costs to store and modify units already in production.

7.90 The classification of changes as “errors and omissions” has been problematic for Public Works on many projects. The standard Public Works consultant agreement states that “the Consultant shall not be entitled to payment in respect of costs incurred by the Consultant in remedying errors and omissions in the services that are attributable to the Consultant, the Consultant’s servants or agents, or persons for whom the Consultant had assumed responsibility in performing the Services.” The agreement, however, does not provide a definition of “errors and omissions”. Public Works has taken the approach that errors and omissions apply to any change notice or change order issued to correct a problem that stems from the lack of co-ordination between the architectural and engineering disciplines during the development of the plans and specifications; or to incomplete details or unworkable details. In such cases, no fees are paid.

7.91 The prime consultants claim that they have never accepted Public Works’ designation of “errors and omissions” and believe that a fairer designation would be “design continuation”; they are claiming approximately \$400,000 in additional compensation. They argue that no sets of plans and specifications are perfect and it is unreasonable to expect them to produce error-free documentation for any project, particularly large projects on the scale of the Winnipeg laboratories.

7.92 In our opinion, there was a need to resolve major disagreements over what constitutes an error or omission instead of allowing them to continue throughout the project, since the Crown’s leverage with the consultants normally diminishes as the project progresses.

7.93 **In consultation with architectural and engineering associations, Public Works and Government Services Canada should clearly define what constitutes design errors and omissions, assign responsibilities for each, and incorporate the definition and responsibilities in project contracts.**

Public Works and Government Services Canada response: Agreed.

Equipment requirements and costs poorly supported and purchases made in advance and in excess of need

7.94 Capital equipment is an integral part of the operations that will be carried out in the new Winnipeg laboratories. In the project approval documents, the departments estimated the cost of equipment purchases at approximately \$23 million, but the project budget identified only \$18.5 million. The remaining \$4.5 million was identified by Health Canada as money that will be required when operations begin in Winnipeg and existing equipment has reached the end of its economic life. At the end of our field work, the departments had acquired equipment for the Winnipeg facility costing approximately \$25.2 million.

7.95 We were informed that all requests for equipment were reviewed and challenged to ensure that only needed equipment was purchased. However, the departments were unable to provide us with documentation or analysis to support their initial estimates of equipment requirements. We found that Agriculture had overestimated its equipment budget by about \$1.7 million, intending to use the excess as a project contingency. It is not clear why Health Canada did not include its total equipment requirements in the project budget. We noted, however, that the total value of equipment purchased by Health Canada is now over double the amount planned. We therefore conclude that the Department did not adequately plan and budget its equipment requirements.

7.96 We noted several instances of purchases made in excess of need and in advance of need, totalling over \$2 million. Exhibit 7.7 provides an example of equipment purchased in excess of need. We also noted that between January 1996 and March 1997, Health Canada purchased equipment totalling \$1.9 million that is currently being stored in Ottawa and Winnipeg.

Exhibit 7.7

Case Study - Waste Disposal Unit

The original specifications in the general contractor's contract included an incinerator, at an estimated cost of \$1.1 million, that would be used to incinerate all waste from laboratories prior to local disposal. We were advised that during a cost-cutting exercise the general contractor stated that an incinerator could be purchased for \$700,000. In the end, a compactor with an attached shredder and autoclave was purchased in place of the incinerator, at a cost of \$410,390.

The use of an incinerator had originally been specified to reduce any public concerns over waste disposal from the facility. The requirement was subsequently reduced to a waste compactor, with an added autoclave. The waste compactor unit is located outside the laboratory containment area, and protocols require that all materials be decontaminated prior to leaving the containment area. Therefore, there is no apparent requirement for an autoclave as part of this waste handling equipment. We were advised that the purpose being served requires only a straight waste compactor, which could have been leased for an annual cost of approximately \$7,200.

Commissioning

Commissioning was generally well managed, but scheduling created problems and added costs to the Crown

7.97 Commissioning is a sequential method of testing and validating results against expected performance criteria for all building components and equipment, systems and integrated systems. The commissioning process involved a three-tiered review by on-site personnel (Tier 1), independent technical and regulatory experts (Tier 2), and a committee of international experts in human and animal health (Tier 3).

7.98 The budget for the construction monitoring and verification program was \$5.3 million. It was based on the general contractor's May 1994 proposed construction schedule that identified 30 June 1996 as the interim acceptance date. The actual total cost of the program to date is not known, because separate accounts were not established to capture and report these costs in the same way as they were budgeted.

7.99 At the end of our field work, integrated systems tests had been completed for the majority of the Canadian Food Inspection Agency's portion of the facility, with satisfactory results. Management has informed us that subsequent to our field work it expects to complete all commissioning by April 1998.

7.100 We noted that the Public Works commissioning team has been involved in all aspects of test validation and system acceptance. The team has gained first-hand experience working with the systems and received technical support and training from the prime consultants and the general contractor. Many of the team members are now responsible for operating and maintaining the facility.

7.101 Management has informed us that all staff will be trained in laboratory procedures and the safe handling of organisms and equipment before work begins in the laboratories. Once the laboratories are operating, the facility's safety and environmental services office will be responsible for monitoring programs, staff procedures and laboratory maintenance to ensure that all safety requirements continue to be met.

7.102 Overall, we found that the commissioning program was generally well managed. We noted, however, that the decision to schedule the commissioning program on the basis of an unapproved construction schedule created inefficiencies, as tests had to be postponed and rescheduled, and resulted in the transfer of contractor responsibilities and costs to the Crown.

Conclusion

A successful, complex project, but stronger management practices would have reduced costs to the Crown

7.103 We conclude that this unique laboratory facility meets, and in some cases exceeds, the client departments' stated requirements. Health Canada and Canadian Food Inspection Agency officials have expressed a high level of satisfaction with the facility. They believe that once fully staffed, the facility will enable them to carry out their mandated programs safely and to be at the forefront of human and animal disease research.

7.104 Capital projects commit the Crown to large one-time capital expenditures and often to even greater ongoing operating and maintenance costs over the life of the asset. It is crucial that departments provide Treasury Board with the best possible estimate of total project costs before a project becomes irrevocably committed. It is equally important that the Treasury Board approval of projects indicate what is being approved clearly enough that senior management can be held accountable for project results. In this project, we noted weaknesses in both these areas.

7.105 We noted a number of instances in which Treasury Board policies and approvals were not respected, and in which the project was not implemented with due regard to economy and efficiency. Information provided to Treasury Board for approving and monitoring this major Crown project fell short of that required in Treasury Board policies. The project was initiated without a proper needs and options analysis. The organizational framework and decision-making processes to manage this complex project contributed to costly delays and a turbulent project management environment. In our opinion, these factors led to diseconomies totalling from at least \$5 million to \$10 million.

Achieving full potential from this expensive world-class facility remains a challenge

7.106 At the end of our field work, many key scientific staff positions had yet to be filled. In addition, the client departments will be operating in a new area as they begin training their professional staff in level 4 laboratory procedures, a first-time experience in Canada. Furthermore, the testing of all systems and integrated systems must be completed successfully as part of the commissioning phase before the laboratories can be made operational, or "go hot". Any serious delays in achieving these milestone events would constitute a major setback for the departments, requiring the continued operation of parallel facilities in the National Capital Region to ensure program response capability.

7.107 The client departments will also need to address the issue of optimizing the use of the facility's laboratory space, which currently exceeds planned occupancy, including considering cost-recovery opportunities.

7.108 This is the first facility in the world to combine laboratories concerned with both human and animal diseases. The facility should provide increased potential for scientific solutions by having health and animal specialists working in partnership in a single facility. The co-location of the two functions has probably also resulted in cost savings over the construction of two separate facilities.

7.109 Once the laboratories are fully functioning, however, potential program issues may present a challenge. While there should be opportunities for synergy and co-operation between the departments, the competing functional priorities that gave rise to difficulties during the design and construction of the facility may serve to limit the achievement of these benefits. We will continue to monitor the efforts of senior management to ensure that in operation, these new facilities achieve their full potential.

About the Audit

Objectives

The objectives of the audit were to determine whether the constructed laboratory facility meets the client departments' stated requirements and the Treasury Board policies and approvals for the project, and whether the project was implemented with due regard to economy and efficiency.

Scope

We examined the major aspects of the design and construction of this major Crown project from the perspective of the generally accepted phases of good project planning and implementation. Specifically, we reviewed the needs definition and statement of requirements, options analysis, project definition and approval, design and contracting, construction and commissioning phases. The commissioning phase had not been completed by the end of our field work.

Our audit was not designed to conclude on whether the Winnipeg laboratories are safe but rather on the extent to which the project team could demonstrate that they are, and that the Health Canada Laboratory Biosafety Guidelines were fully addressed in the design and construction of the facility. This includes the establishment of a formalized process for the review and sign-off of biosafety issues by the appropriate competent authorities. We also reviewed the roles and responsibilities of Health Canada's Office of Biosafety and Agriculture and Agri-Food's Biohazard Containment and Safety Unit.

Criteria

Our audit criteria were derived from the established methodologies of this Office for auditing capital asset projects and from the Treasury Board policies for managing major Crown projects. Health Canada's Laboratory Biosafety Guidelines and Agriculture and Agri-Food Canada's Containment Standards for Veterinary Facilities provided the criteria for assessing biosafety issues.

Approach

We interviewed most of the key departmental program and project officials and reviewed relevant project files and documents. Our field work included site visits to the new Winnipeg laboratories, Health Canada's existing facilities in Ottawa and Winnipeg, Agriculture's/the Canadian Food Inspection Agency's existing laboratories in the National Capital Region, and visits to the U.S. Centres for Disease Control and Prevention in Atlanta, Georgia and the U.S. Department of Agriculture Foreign Animal Disease Diagnostic Laboratory at Plum Island, New York.

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Chapter 8

Department of Finance —

Effectiveness Measurement and Reporting

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Department of Finance —

Effectiveness Measurement and Reporting

Main Points

8.1 In addition to functions that include preparing the Budget and providing economic policy advice to the government, the Department of Finance has responsibilities related to a number of policies and programs. The Department's 1997-98 planned expenditures of \$66 billion account for 43 percent of planned federal expenditures. The Department is also responsible for federal tax policy, including preferential tax provisions that are intended to lead to the achievement of a variety of government policy objectives.

8.2 The significance of the Department's policy and program responsibilities underlines the importance of its obligation to make known to Parliament and to the public, in a clear and meaningful manner, the nature and extent of those responsibilities, the objectives involved and the results achieved relative to those objectives.

8.3 Improvement is required in providing Parliament with clear and consistent statements of objectives and of the Department's policy and program-related responsibilities. For many policies and programs, the Department shares responsibilities with other departments and agencies. We found a general lack of clarity in documents directed to Parliament about the other departments and agencies involved and the manner in which responsibilities are shared.

8.4 We found gaps in reporting to Parliament on results achieved relative to objectives. Our findings in this audit are consistent with the findings of a number of audits of individual policies and programs undertaken by this Office over the past six years. The picture that emerges is one of known shortcomings, and insufficient attention to measuring effectiveness and reporting results to Parliament and the public.

8.5 Legislative provisions governing a number of the Department's policies and programs have been the subject of review by Parliament to consider whether the provisions should be changed to improve performance and to enable policies and programs to be adapted to new circumstances. Such legislative reviews are valuable in their own right; they are not, however, a substitute for systematic measurement and reporting of effectiveness information by the Department. We believe legislative reviews would be enhanced by Parliament having more regular and timely access to information on the results that policies and programs have achieved.

8.6 Planning for effectiveness measurement and reporting is not sufficiently linked with the Department's corporate planning process. The Department's current approach results in an effectiveness measurement function that is partial in coverage and not clearly integrated with the overall corporate management structure. In view of the limited resources allocated specifically to the function, we are concerned about the Department's capacity to meet its obligations to account to Parliament for results achieved.

Introduction

The Department of Finance plays a pivotal role within the government

8.7 The Department of Finance operates under sections 14-16 of the *Financial Administration Act*. These provide the Minister of Finance with the broad responsibility for “the management of the Consolidated Revenue Fund and the supervision, control and direction of all matters relating to the financial affairs of Canada not by law assigned to the Treasury Board or to any other Minister.” The roles and responsibilities of the Department are outlined in Exhibit 8.1.

Exhibit 8.1 is not available, see the Report

Roles and Responsibilities of the Department of Finance

8.8 As the exhibit indicates, a basic function of the Department is to assist and support the Minister of Finance in his role as the key policy minister for economic and fiscal matters. The Department provides this assistance and support in the context of the Minister’s Cabinet responsibilities and accountability to Parliament.

8.9 The Department plays a central, strategic role within the federal government. Its functions include preparing the Budget and providing economic policy advice to the government. The Department exercises central agency functions in the oversight and co-ordination of those activities of departments and agencies that affect the economy. In addition to its policy advisory and central agency roles, the Department has a number of direct responsibilities related to policies and programs. These responsibilities carry the concomitant obligation to account to Parliament for results achieved relative to established objectives. The Department’s planned expenditures of \$66 billion account for 43 percent of planned federal expenditures of \$152 billion for 1997-98.

The Department has direct responsibilities related to a number of policies and programs

8.10 The Department’s direct responsibilities for policies and programs relate to such matters as their design, supervision, management or implementation. In some cases, the responsibilities are shared with other federal departments; in others, the Department shares responsibility or works closely with provincial and territorial governments. It is the direct policy and program-related responsibilities of the Department, as distinct from its central agency, Budget and policy advisory roles, that are the focus of this audit.

8.11 Exhibit 8.2 outlines areas where the Department has direct policy and program-related responsibilities. It also identifies cases where those responsibilities are shared with other departments. The policy and program areas listed in Exhibit 8.2 cover a wide range of activities and account for a very substantial level of expenditure, most of it statutory. Statutory expenditures are authorized by the Act of Parliament that establishes the program, but are not subject to annual scrutiny and review as part of the parliamentary supply process.

Exhibit 8.2

Areas Where the Department of Finance Has Direct Policy and Program-Related Responsibilities

Policy/Program Area	Budget/Expenditures	Responsibilities Shared With:
Public Debt Management	<ul style="list-style-type: none">1997-98 budget of \$46.0 billion (includes interest and other costs)¹	Bank of Canada

Federal–Provincial Transfer Payments Program	<ul style="list-style-type: none"> • 1997-98 budget of \$19.4 billion¹ • an additional \$12.6 billion is provided in tax transfers 	Health Canada Human Resources Development Canada
International Trade and Investment Policy	<ul style="list-style-type: none"> • 1997-98 budget of \$2.4 million² 	Foreign Affairs and International Trade Canada Revenue Canada
International Financial Organizations	<ul style="list-style-type: none"> • 1997-98 budget of \$694.3 million¹ 	Canadian International Development Agency
Regulatory Framework: Canadian Financial Services Sector	<ul style="list-style-type: none"> • 1996-97 expenditures were \$1.8 million 	Office of the Superintendent of Financial Institutions Canada Deposit Insurance Corporation Bank of Canada
Federal Tax System	<ul style="list-style-type: none"> • 1997-98 budget of \$10.3 million (does not relate to the value of tax revenue) 	Revenue Canada
Canada Pension Plan (joint responsibility of federal and provincial governments)	<ul style="list-style-type: none"> • Funded by direct premium revenue 	Human Resources Development Canada Office of the Superintendent of Financial Institutions Revenue Canada Public Works and Government Services Canada
Privatization	<ul style="list-style-type: none"> • Responsibility transferred from Treasury Board Secretariat in June 1997 • Annual budget \$0.3 million (estimate) 	
Special Program (payments to fund Canada's equity interest in Hibernia)	<ul style="list-style-type: none"> • 1997-98 budget of \$58.0 million 	
Domestic Coinage (production and shipment of coins)	<ul style="list-style-type: none"> • 1997-98 budget of \$38.0 million 	Public Works and Government Services Canada Royal Canadian Mint

¹ With minor exceptions, these expenditures are statutory.

² Budget of the International Trade Policy Division of International Trade and Finance Branch.

Source: 1997-98 Estimates Part III for Department of Finance and Human Resources Development Canada; documentation provided by Department of Finance

8.12 The most substantial of the expenditure programs relate to the management of the public debt, with an estimated budget of \$46.0 billion for 1997-98, and the Federal–Provincial Transfer Payments program, with an estimated budget of \$19.4 billion and a further \$12.6 billion in tax transfers. Transfers under various statutory

authorities include equalization payments, the Canada Health and Social Transfer and a variety of other transfers to provincial and territorial governments.

8.13 Among the Department's other policy and program-related responsibilities are those related to the regulatory framework for the Canadian financial services sector, and representation of Canada's interests in various international organizations, including the International Monetary Fund, the World Bank and the European Bank for Reconstruction and Development. In addition, the Department plays a central role in the development, management and implementation of Canadian international trade and investment policy. Among other things, the Department leads or directs the government on import policy, in particular on tariff and trade remedies, and is responsible for related domestic legislation and regulations.

8.14 The Department is responsible for the development and evaluation of federal taxation policies and legislation, including various preferential tax provisions. Many of these provisions reduce corporate and personal tax liabilities. By providing assistance or incentives to targeted groups of individuals and businesses, the provisions are intended to lead to the achievement of specific objectives (including goals in areas such as social, cultural, economic and regional policies). These so-called "tax expenditures" include provisions such as tax exemptions, deductions, deferrals and tax credits.

8.15 Finally, the Department has certain responsibilities under the Canada Pension Plan (CPP). The CPP is a joint responsibility of the federal and provincial governments and is funded by its own direct premium revenue. Changes to benefits, to the rate of contributions, or to investment provisions require an Act of Parliament and supporting orders-in-council from at least two-thirds of the included provinces, representing at least two-thirds of the population of all included provinces. The Department is responsible for leading negotiations with the provinces, and all other aspects of the statutory reviews that result in recommendations for changes to the CPP. In the past, the Department has also been responsible for the administration of the CPP Investment Fund. As of April 1998, the CPP Investment Board is responsible for investing new CPP funds in a diversified portfolio of securities, although the Department remains responsible for the administration of the existing portfolio of loans to the provinces and (with provinces) for the legislative framework for CPP investment policy.

8.16 In view of the extent and consequences of the Department's policy and program responsibilities (involving a variety of instruments such as transfers, legislation, regulation and selective tax measures), effectiveness measurement and reporting are crucial. Information on results is needed to account to Parliament and Canadians for what has been achieved relative to established objectives, as well as to help improve future performance.

The need to measure and report effectiveness is embedded in government policy

8.17 Effectiveness measurement involves examining the extent to which government policies, programs and operations are achieving their objectives, as well as identifying other positive or negative effects. As we emphasized in our 1996 Report (Chapter 3: Evaluation in the Federal Government), information about the "bottom line" of government activity requires, among other things, disciplined measurement and analysis of effectiveness. In practice, a variety of approaches can be used, including, for example, evaluations conducted by evaluation or review units, reviews led or mandated by senior management or by program managers, and analyses of information from the ongoing monitoring of policies, programs or operations.

8.18 The government has embedded in policy the need for information on results to support decisions, improve the way government works and provide accountability. The 1994 Treasury Board Manual on Review, Internal Audit and Evaluation (Review Policy) seeks to ensure that the government has timely, relevant and evidence-based information on the performance of its policies, programs and operations, and that it uses this information to improve their management and cost-effectiveness as well as to account for results.

8.19 Under the Review Policy, deputy heads of departments are accountable for, among other things, ensuring that departmental programs and policies are functioning as intended, that appropriate review mechanisms are being used, and that review information is used in decision making and accountability reporting.

8.20 The improvement of information on performance to aid decision making and facilitate accountability is a key feature of the government's revised expenditure management systems. As well, in his 1996 Annual Report to Parliament (*Getting Government Right: Improving Results Measurement and Accountability*), the President of the Treasury Board strongly emphasized the importance of evaluating the actions of government and reporting publicly on the results (see Exhibit 8.3).

Exhibit 8.3

Public Reporting of Effectiveness Information Is Required by the Government and Expected by Parliament

Annual Report to Parliament by the President of the Treasury Board, *Getting Government Right: Improving Results Measurement and Accountability*, 1996. The report stated:

The government must equip itself with better systems for evaluating its actions so that it can genuinely answer for these actions, first and foremost to Canadians, who are both clients and taxpayers. This is the only way government can evaluate and debate the merits of the decisions it makes every day on the public's behalf.

Standing Committee on Procedure and House Affairs, *The Business of Supply: Completing the Circle of Control*, Sixty-Fourth Report, April 1997. Among other things, the report stated:

Debt and deficits, the fewer resources available to governments, and debate as to how these resources should be best applied as well as about the proper role for government all figure prominently in the public discourse of the day. Canadians expect their Parliament will play a central role in these debates by exploring alternative policy options, holding government and its bureaucracy accountable, educating the public while respecting and representing its views and concerns, and, at the end of the day, being at the table when difficult choices are made.

Performance documents should include status reports on ongoing evaluations conducted on new and existing programs, including those involving statutory expenditures, as well as reports on evaluations that have been completed. In particular, evaluations must articulate objectives, address the question of whether or not the objectives are being met, whether the program is being efficiently managed, and whether there are alternative means of achieving the objectives.

Parliament and the public expect reporting of information on results

8.21 Canadians expect the government to spend tax dollars wisely and report on results achieved. Surveys of public opinion show that the availability of results information influences the confidence that citizens and taxpayers have in their governmental institutions.

8.22 Public reporting of effectiveness information also serves Parliament in the exercise of its scrutiny and legislative functions. The government develops initiatives and undertakes expenditures subject to the approval of Parliament. Public accounting for the results achieved with the expenditures and authorities approved is a vital step in parliamentary control. This requires making the objectives of policies and programs, and the results achieved relative to those objectives, known to Parliament and to the public in a timely and meaningful manner. The information needs to be clear, concrete and understandable, and accessible to all parliamentarians. Although individual accountability documents cannot always include all the information that might be appropriate, they can provide clear references to other sources.

8.23 Parliament has maintained its interest in results information. As we noted in Chapter 3 of our 1996 Report, the Standing Committee on Public Accounts reaffirmed its interest in program evaluation in its November 1994

Sixth Report. Further, a recent report of the Standing Committee on Procedure and House Affairs (The Business of Supply: Completing the Circle on Control, April 1997) emphasized that effectiveness information is central to many of the key public debates of the day (Exhibit 8.3).

Focus of the audit

8.24 Our audit objectives were:

- to determine the extent to which the Department of Finance undertakes effectiveness measurement and reports publicly on the achievement of objectives in those areas where it has direct responsibilities related to policies and programs; and
- to determine the extent to which the Department has the capacity, structures and procedures to measure adequately and report publicly on the effectiveness of its policies, programs and operations.

8.25 The scope of our audit included components of all the policy and program areas identified in Exhibit 8.2, with the exception of those related to privatizing certain Crown corporations, to the Special Program (payment of Canada's equity interest in the Hibernia oil development), and to Domestic Coinage (costs of production and shipment of coins). In the case of the federal tax system, we focussed on tax expenditures.

8.26 In 1993, at the request of the Standing Committee on Public Accounts, we carried out a special audit of changes that had been introduced in the organizational approach to effectiveness measurement in the Department's Tax Policy Branch (The Revised Approach to the Evaluation of Tax Measures at the Department of Finance, March 1993). Our 1993 audit concluded that evaluations produced by the Branch under the new organizational approach met established measurement and analysis standards for the evaluation questions they addressed, whereas evaluation studies under the old organization did not consistently do so. We also found that important questions were addressed in the studies produced under the new approach.

8.27 We raised concerns, however, regarding the approach of the Tax Policy Branch to establishing priorities for effectiveness measurement. We also noted that fewer resources were being dedicated to evaluations and urged that an adequate effectiveness measurement capacity be maintained within the Branch. Our findings in 1993 were tentative because the organizational changes were recent. The present audit was therefore designed to follow up on the observations we reported in 1993.

8.28 Further details about the approach and scope are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Accountability to Parliament for Results

8.29 To assess the extent to which the Department meets its obligation to account to Parliament for results, we sought to determine whether, in material available to Parliament, the Department clearly identifies the policies, programs and operations for which it is accountable (including the nature and extent of its accountability); states their objectives clearly and consistently; and reports the results achieved.

Improvement in communicating responsibilities to Parliament is required

8.30 We examined a range of public documents produced by the Department, each of which could reasonably be regarded as authoritative for purposes of reporting to Parliament (Estimates documents, federal budget papers, White Papers and annual reports). Our purpose was to assess the clarity of information regularly available to Parliament about the Department's responsibilities, including how they relate to those of other departments and agencies with responsibilities in the same policy and program areas.

8.31 We found that the Department's statements of its own responsibilities were not clear in two of the areas we examined. In addition, where responsibilities are shared with other departments and agencies, we found a general lack of clarity about the organizations involved and the manner in which responsibilities are shared among them.

8.32 The Department shares responsibilities with other departments and agencies in many of the policy and program areas we included within the scope of this audit. In none of these areas, however, do the documents we reviewed consistently identify the other organizations involved or how their responsibilities relate to those of the Department of Finance. As a result, the accountability frameworks for these policy and program areas are not always clearly communicated to Parliament.

8.33 The failure to articulate clearly the accountability frameworks for the policies and programs we reviewed was particularly evident in Estimates documents. For example, although the Department shares some responsibilities with Foreign Affairs and International Trade Canada and Revenue Canada in the development, management and implementation of Canadian trade and investment policy, its 1997-98 Estimates documents make no mention of this. We recognize that there are limitations on the amount of information that can be provided in any one document. However, we believe that, as a minimum, identification of the departments and agencies involved, with cross-references to other sources of related information, is essential to provide Parliament with a clear perspective on accountability.

8.34 One of the two cases where we noted that statements of the Department's own role were not clear relates to Finance's responsibilities for the Canada Pension Plan (CPP). We found that the Estimates documents provide only limited information on the Department's responsibilities. In addition, they do not make any reference to the fact that information on the nature and extent of the Department's responsibilities can be found in the CPP annual report.

8.35 The other case where we found that Parliament did not receive clear information about the Department's responsibilities relates to the regulatory framework for the financial services sector. The 1997-98 Estimates documents indicate that the Department is responsible for "the functioning of and regulatory framework for Canadian financial markets and institutions." Although the Department acknowledges its responsibility for policy development related to the functioning of Canadian financial institutions, as well as for the regulatory framework that applies to them, it does not in fact have responsibility for the broad functioning of financial markets. The Department told us that it intends to clarify the statement of its responsibility in this regard in future Estimates documents.

8.36 **The Department of Finance should ensure that the information it provides regularly to Parliament clearly and consistently identifies its own responsibilities, the departments and agencies with which it shares responsibilities and the manner in which the responsibilities are shared.**

Department's response: The Department already does this. The 1998-99 Main Estimates provide more substantial information on the CPP as suggested. In addition, the audit suggests that the role of the Department in CPP is not well known. However, the Department's role has been made clear in documents, speeches and even a special web site. There were statements in every Budget presented to Parliament starting in 1994; a special CPP web site was created (winter 96); a Report on Consultations was published (June 96); a federal/provincial agreement was reached on measures to make the CPP sustainable, followed by a speech in Parliament and the tabling of draft legislation (February 97); and finally, legislation was introduced, a new actuarial report was tabled in Parliament,

and a press release was issued summarizing the bill (September 97). Further, the recently concluded federal/provincial review included a number of measures to significantly improve information reporting and stewardship for the CPP.

Parliament needs better information on objectives

8.37 An essential requirement for accountability to Parliament is that departments identify clearly the objectives of program expenditures and other initiatives when seeking Parliament's approval for them in appropriation or other Acts. Clear objectives, consistently stated, provide a firm and transparent basis for public debate and decisions. Similarly, they greatly aid parliamentarians and the public in subsequently assessing the results achieved.

8.38 It is important here to distinguish between operational objectives and policy or program objectives. The Department's operational objectives may vary from year to year — for example, in dealing with specific intentions or targets in planning, consultation or negotiation related to some aspect of policy development or program implementation. Although such information is useful in identifying operational activities to be performed and milestones to be reached, it is the policy or program objectives (the things to be accomplished as a result of the policy or program) that are central to establishing the basis for accountability to Parliament. It is in relation to these objectives that Parliament needs information on results.

8.39 We examined a range of public documents to determine whether they provide Parliament with good information on policy and program objectives. It is important for objectives to be articulated not only clearly, but also consistently across information sources.

8.40 We found that objectives were both clear and consistently stated for the Public Debt program, the Federal-Provincial Transfer Payments program and the International Financial Organizations program.

8.41 With respect to international trade and investment policy, we examined the Department's Estimates documents, the Departmental Outlook, the Federal Regulatory Plan, and the publication titled Finance Canada — Structure and Role. With the exception of some recent Estimates documents, which made limited reference to "improving Canadian competitiveness" through a variety of specific policy reform and consolidation measures, none of these documents included any statements of objectives for the international trade and investment policy responsibilities of the Department.

8.42 We noted that the Estimates documents contain neither information on program objectives for the Canada Pension Plan nor directions to other sources where such information is available. The Estimates documents also do not provide statements of objectives for the regulatory framework for the financial services sector. In addition, we found that two public documents issued by the Department (Enhancing the Safety and Soundness of the Canadian Financial System, February 1995; and 1997 Review of Financial Sector Legislation: Proposals for Changes, June 1996) do not provide clear statements of the objectives of the regulatory framework.

8.43 The Department provides Parliament with a special annual report on tax expenditures. Our findings on that report are presented in paragraphs 8.62-8.64.

8.44 The Department of Finance should provide Parliament with clear and consistent statements of objectives for the full range of its policy and program-related responsibilities.

Department's response: The Department already does this. However, it agrees that, wherever feasible, it will examine its procedures and provide more public information on the broad policy objectives and the extent to which they are being met.

Insufficient attention to providing effectiveness information to Parliament

8.45 The Department told us that effectiveness information has regularly been reported to Parliament in its Estimates documents, Budget papers, government White Papers or through other means. We examined the documents identified by the Department, including its pilot Performance Report for the period ending 31 March 1997. We assessed the documents against the basic requirement that effectiveness information should address the extent to which programs are achieving their objectives.

8.46 We found significant gaps in the public reporting of results relative to objectives in all the areas included within the scope of our audit. In most cases, reporting focussed on specific areas of operational activity or progress, but did not provide information on the achievement of objectives.

8.47 In the Department's 1997 Performance Report, the information provided for the Public Debt program went furthest in reporting on program effectiveness. In this case too, however, some additional information would have strengthened the report. For example, the report describes indicators of the efficiency of Canada's financial markets and states that Canada's performance in terms of those indicators compares favourably to that of other countries with highly developed capital markets. We believe the report would have been more useful had it included the actual measurements — including comparisons with other countries, and changes in those measures over time.

8.48 The Department told us that it did not provide detail in the Performance Report because it is a summary overview of performance. It noted, however, that more detail had been provided in recent Debt Operations Reports. In these circumstances, a reference to the additional detail in Debt Operations Reports would be essential to assist readers of the Performance Report.

8.49 Where programs are subject to legislative review, we found that some information on results is generated in that context. However, based on an examination of three reviews, we have concluded that legislative reviews do not eliminate the need for the Department to undertake systematic and disciplined measurement and reporting of effectiveness. Indeed, we believe the timely reporting of effectiveness information would help inform public and parliamentary debate and enhance the legislative review process (paragraphs 8.76-8.96).

8.50 The findings of our current audit about deficiencies in effectiveness measurement and reporting are consistent with the findings of a number of audits undertaken by this Office from 1992 to 1997. The policy and program areas examined in these earlier audits cut across a wide range of the Department's responsibilities.

8.51 Summary findings relating to effectiveness measurement and reporting from these earlier audits are outlined in Exhibit 8.4. At the time the audits were undertaken, there was only one case — the management of the public debt — where we were able to report that an evaluation was under way.

8.52 The situation regarding the effectiveness measurement of tax expenditure provisions is more positive. Although a number of the audits outlined in Exhibit 8.4 identified shortcomings in measuring the effectiveness of tax expenditures, during the current audit the Department identified a range of initiatives it believes to be related, in whole or in part, to effectiveness measurement. However, in view of the materiality and the importance of the objectives of many tax expenditures, we concluded in this case too that providing accountability information to Parliament on the extent to which objectives have been achieved deserves more attention. A more detailed discussion of the Department's approach to measuring and reporting the effectiveness of tax expenditures is presented in paragraphs 8.59-8.75.

Exhibit 8.4

Findings from Earlier Audits and Studies on Effectiveness Measurement Activities, 1992-1997¹

Year	Audit/Study	Effectiveness Measurement and Reporting	Audit/Study Findings
1997	Federal-Provincial Transfers (Equalization Program)	Insufficient	"...little information is regularly provided to Parliament on the workings of the Equalization Program....The Department of Finance's Part IIIs have not reported to Parliament on the way the program works or on its performance."
1996	Goods and Services Tax: New Housing Rebate	Insufficient	"An evaluation of the New Housing Rebate Program is needed."
1996	Federal Debt Management	Five-year evaluation under way	"The debt managers... have not yet been able to develop appropriate methodology to enable them to assess...whether and how well they have succeeded in achieving their primary objective....Such an assessment is not a simple task....We recognize that there are a number of challenges and constraints to developing a meaningful methodology...."
1996	Evaluation in the Federal Government	Sizeable coverage	The audit found that the Management of Public Debt program had received sizeable evaluation coverage.
1996	Excise Duties and Taxes on Selected Commodities	Insufficient	"...the Department has no current plans to evaluate any commodity tax...."
1996	Child Tax Benefit and Goods and Services Tax Credit Programs	Insufficient	"Neither program is a priority for evaluation."
1995	Regulatory Framework - Deposit-taking Institutions	Insufficient	"...there has been no comprehensive evaluation for the regulatory framework to see whether it has been effective in meeting the objectives."
1994	Tax Assistance for Retirement Savings	Insufficient	"Evaluation studies do not address key results and other issues of major concern."
1994	Income Tax Incentives for Research and Development	Insufficient	"At the time of our audit, no formal evaluation of the tax incentives for research and development had been done."
1992	Department of National Revenue-Customs and Excise - <i>Special Import Measures Act</i>	Insufficient	"...Finance, the department responsible for policy and legislation... has not completed a formal evaluation of the program since the Act came into force in 1984."

¹In addition to these regular program audits, in 1993 we undertook a special audit of effectiveness measurement within the Tax Policy Branch. That audit and the current audit identified nine tax measures that have been evaluated during the 1990 to 1997 period.

Source: Office of the Auditor General

8.53 In assessing the Department's commitment to measuring and reporting effectiveness, we also reviewed the Department's submission in the 1997 Annual Report to Parliament by the President of the Treasury Board (Accounting for Results, October 1997). Among other things, that report is intended to identify the results that government departments are committed to providing for Canadians as well as the methods they will use to demonstrate the results achieved.

8.54 We noted in Chapter 5 of our 1997 Report (Reporting Performance in the Expenditure Management System) that the Report of the President of the Treasury Board is an important step in providing accountability

information to Parliament. The value of the information, however, depends on the nature of the results commitments and indicators proposed. We found that the results commitments of the Department of Finance in the 1997 President's Report are very general in nature (for example, "secure social programs"). Moreover, the means by which the results are to be demonstrated do not speak clearly and unambiguously to achievements related to policy or program objectives. For example, the Department's commitment to secure social programs is to be demonstrated by "implementation of new programs" and "improvements to existing social programs".

8.55 The Department of Finance should review the priority it assigns to accounting to Parliament for the effectiveness of its policies and programs and take steps to address the shortcomings we have identified.

Department's response: The Department already makes great efforts to achieve this objective. As the Department's overall response at the end of the chapter makes clear, the report is misleading in its conclusions on the Department's efforts. The Department undertakes reviews, analysis, and ongoing monitoring, and publishes a wide range of evaluations in a variety of forms, such as Budgets, consultation papers, press releases, regular reports, etc. The audit ignores this and, instead, focusses only on a narrow range of publications in order to conclude that effectiveness reporting is lacking. In fact, effectiveness reporting, like effectiveness measurement, is a large part of the Department's mandate and a key priority. If the wide range of publications produced by the Department were examined for effectiveness measurement, it would be apparent that the Department does, in fact, give priority to accounting to Parliament for the effectiveness of its programs and policies.

The audit ignores the fact that decisions always have to be made given a very real resource constraint and that, even with the best will in the world, it is not possible to continuously evaluate, in a formal sense, all policy and make this supply of information on effectiveness measurement public. The audit fails to examine whether, given this constraint, an increase in formal evaluation studies would provide the best "value for money" for Canadians.

8.56 Effectiveness information can support accountability and change. A legislative review of the Canada Pension Plan in 1996 showed that a number of major deficiencies had evolved over time. As Exhibit 8.5 indicates, among the changes proposed were strengthening the program's stewardship, as well as accountability to Parliament and to the public.

Exhibit 8.5

Stewardship and Accountability for the Canada Pension Plan

- The Canada Pension Plan (CPP) provides contributors and their families with a basic level of protection against loss of earnings due to retirement, disability or death of a contributor to the program. Estimated disbursements for 1997-98 are \$17.8 billion.
- In February 1997, the government released *Securing the Canada Pension Plan: Agreement on Proposed Changes to the CPP*. The report stated:
 - economic and demographic realities have changed significantly over the years without adequate response (by CPP);
 - enrichments to benefits have repeatedly been made without proper adjustments to contributions; and
 - administrative procedures have strayed from the intent of the legislation.
- The government called for the stewardship and accountability for the Plan to be strengthened. Among other things, the government noted, "annual reports ... tabled in Parliament will be more complete in the information they provide, and will in particular explain how administrative problems are being addressed."
- A legislative review of the CPP in 1996 led to major changes to the Plan in the legislation passed in 1997.

Source: Human Resources Development Canada and Department of Finance

8.57 We examined two additional cases (one within the Department of Finance and the other within Human Resources Development Canada) where there was evidence of benefits accompanying the measurement and reporting of effectiveness. The results, as outlined in Exhibit 8.6, suggest that effectiveness information was a contributing factor in bringing about changes in program design and subsequent policy development.

Exhibit 8.6

Examples of Public Reporting on Program Effectiveness

Department	Program	Budget	Key Effectiveness Results Reported to Parliament	Program Change
Department of Finance	Cape Breton Investment Tax Credit	Over \$500 million in forgone taxes	1990: Of \$2.1 billion in investment funded under the program, more than 80 percent would have occurred anyway (without program assistance).	Preliminary findings were among factors considered in decision not to extend the tax credit.
Human Resources Development Canada	Unemployment Insurance	\$17.6 billion (1993-94)	1994: Program strengths and weaknesses were identified, including negative program design features influencing worker/employer behaviour and increased unemployment effects. ¹	New legislation (1995) <ul style="list-style-type: none"> - clarified objectives - provided formally for regular program evaluation - strengthened reporting - revised program structure

¹ In addition to the Department's evaluation, we undertook a study of the program, which we reported to Parliament in 1994.

Source: Office of the Auditor General

8.58 In both case examples — the Cape Breton Investment Tax Credit (evaluated by the Department of Finance's Tax Policy Branch), and the former Unemployment Insurance Program (evaluated by Human Resources Development Canada) — effectiveness measurement and reporting were accompanied by significant developments affecting the programs. These developments in large part reflected, or were consistent with, the directions indicated by the effectiveness information that had been produced. It is worth noting that in both cases the information was publicly reported and was subject to considerable public scrutiny and debate.

Parliament needs better information on the objectives and results of tax expenditures

8.59 As noted earlier, tax expenditure provisions have been established under the federal tax system to promote the achievement of government policy objectives, including social, cultural, economic and other goals. The provisions range, for example, from tax relief from the Goods and Services Tax covering basic groceries to tax breaks for corporations to promote certain types of investments and tax breaks for individuals to encourage retirement savings. Exhibit 8.7 provides further examples of tax expenditures.

Exhibit 8.7

Examples of Tax Expenditure Measures

Category	1997 Projected Value (\$ million)
Personal Income	
- Registered Retirement Savings Plans	6,540
• Tax Deductions for Contributions	5,180
• Non-Taxation of Investment Income	685
- \$500,000 lifetime capital gains exemption for small business shares	
Corporate Income	
- Low tax rate for small businesses	2,620
- Scientific research and experimental development investment tax credit	965
GST	
- Basic groceries	2,850
- Rebates for municipalities	565

Source: Department of Finance, Government of Canada Tax Expenditures, 1997

8.60 Using the tax system to deliver government programs provides for less control over program and resource use than using direct government expenditures. Management procedures, including effectiveness measurement, need to recognize and respond to this characteristic. In addition, the need to report results to Parliament merits particular attention because the process of parliamentary control and accountability for tax measures differs from other government programs.

8.61 Tax expenditure provisions are not subject to regular annual scrutiny and debate as are those programs that go through the parliamentary supply process. Neither are they automatically subject to periodic legislative reviews. The enabling legislation for tax measures does not normally contain sunset provisions. Specific tax expenditure provisions are usually introduced as part of the Budget and result in later amendments to the *Income Tax Act*.

8.62 Annual reports on tax expenditures. In recognition of these characteristics, the Department of Finance publishes annually a list of tax expenditures, along with estimates of the tax revenue forgone for each one. We noted that this report has not been published on a regular basis. Of the past five reports, two were published in August, two in December and one in February. We believe that a regular publication schedule, co-ordinated with the cycle of the expenditure management system, would enhance the report's potential as an accountability vehicle for Parliament.

8.63 The Department's annual tax expenditure reports provide historical estimates, based on a sample of taxpayer returns and other statistical data, of a range of individual tax measures that the Department indicates could be considered to be tax expenditures. The 1997 report provides historical data for various periods, depending on the tax system and the last year for which data are available. For the personal income tax system, data are provided for 1992, 1993 and 1994; for the corporate income tax system, for 1992 and 1993; and for the Goods and Services Tax, from 1992 to 1995. In addition, the report provides projections, beyond the last historical year, to 1999.

8.64 The tax expenditure report includes descriptions of the many provisions, and, in the case of the personal tax system, categorizes them in a way that gives a broad indication of their area of impact (for example, employment, education, income maintenance and retirement). The report does not, however, provide information about the specific objectives that each provision is designed to achieve. Moreover, the report provides no information on the effectiveness of tax measures in achieving their objectives. The Department told us that it is planning to change the nature of the tax expenditure reports to include information from evaluations and analyses of tax measures, and that it is considering including the specific objectives of each tax expenditure in the 1998 report.

8.65 Objectives of tax expenditures. We found that the objectives of some of the tax expenditure provisions we examined in more detail were not clear. The Department states that tax expenditures are put in place to achieve a variety of economic, social and other objectives. We therefore expected to find that the Department would have identified their objectives in these terms, as well as the manner in which they could be expected to contribute to the policy objectives concerned. Among the 15 specific provisions we examined, we found cases where objectives were not clearly stated.

8.66 For example, the Department told us that there is no public statement of formal objectives for the non-taxation of employer-paid private health and dental benefits. In the case of the Goods and Services Tax rebates for municipal bodies and related boards and commissions, the Department stated that the purpose is to provide continuity in the exemptions from sales tax under the previous federal tax system. In our view, this provides no indication of the actual results to be achieved by the rebates or of linkages to the government's wider policy objectives.

8.67 The Department of Finance should:

- **identify clear objectives for each tax expenditure in terms of its intended contribution to economic, social or other objectives;**
- **report the objectives to Parliament in the annual report on tax expenditures;**
- **report summary effectiveness information in the annual report on tax expenditures where available;**
and
- **establish a schedule for publishing the annual report on tax expenditures that complements the expenditure management cycle.**

Department's response: With respect to the specific objectives of tax expenditures, the Department will include these in the 1998 tax expenditure report, which we anticipate will be published in the spring of 1998.

Regarding the publication of summary effectiveness information, it is anticipated that the tax expenditure report will include further analysis and evaluation of specific tax expenditures and summary effectiveness information. It should be recognized that such analysis and reporting does not need to be done on an annual basis since most tax expenditures are not changed from year to year.

With respect to the need for regular publication of the report on tax expenditures that is co-ordinated with the cycle of the expenditure management system, the Department agrees and plans to publish the tax expenditure report in the spring of each year.

8.68 Measuring the effectiveness of tax expenditures. The Department's 1997 tax expenditure report indicates that there are more than 150 provisions that could reasonably be regarded as tax expenditures. The annual revenue costs of individual provisions range widely, from a few million to many billions of dollars. In light of such

differences, as well as differences in their purposes, we recognize that not all the tax expenditure provisions warrant the same degree of attention in terms of effectiveness measurement and reporting.

8.69 The Tax Policy Branch told us that it uses a variety of techniques that contribute to effectiveness measurement. In addition to carrying out some in-depth evaluations of specific provisions, the Branch monitors the operation of individual provisions on an ongoing basis and undertakes internal analyses and assessments of issues brought to its notice through sources that include individual taxpayers, parliamentary committees, Revenue Canada and the Department of Justice. These analyses result in many changes to the tax system each year.

8.70 Other techniques include external reviews. For example, in 1996 the Department established a Technical Committee on Business Taxation. The Committee's mandate is far-ranging, including assessing the fairness of business taxation and considering ways in which it might contribute more to job creation and economic growth. As the Committee's work was still under way when we completed this audit, we were unable to determine the extent of the contribution it will make to measuring the effectiveness of tax expenditures.

8.71 Accounting to Parliament for the achievement of objectives. We recognize the importance of external reviews, as well as the ongoing monitoring and adjustment of tax measures to deal with operational problems as they arise. We do not believe, however, that these activities are sufficient to fulfil the Department's obligation to account regularly to Parliament and Canadians for the results achieved relative to the policy objectives established for specific tax expenditures. In our view, reporting on the achievement of objectives is central to providing accountability to Parliament, and should not be limited to situations where the government has concluded that certain provisions need to be changed.

8.72 In this context, we assessed the extent of the information available to Parliament over the eight-year period 1990-97 on the achievement of the objectives of various tax expenditure provisions. We found that Parliament has received such information largely as a result of tax expenditure evaluations, and that the output of such evaluations has been modest. Over the 1990-97 period, only five tax expenditure evaluations were completed, and, when we completed our audit, two were under way. By way of comparison, we note that there are about 150 tax expenditure provisions, of which 14 involve more than \$1 billion annually in forgone tax revenue. Although the value of forgone tax revenue is not the only relevant criterion in this regard, it is frequently an important one.

8.73 The Department's view is that major studies or evaluations are generally only appropriate in situations where there may be concern about effectiveness. The Department notes that, based on the application of a value-for-money criterion, it adopts a variety of approaches as problems are identified through the monitoring of tax expenditures. These approaches may range from immediate remedial action to major evaluations. The Department's position is that it publishes information in documents such as the Budget Plan, consultation papers and press releases on the effectiveness measurement and analysis that leads to proposed changes. The Department notes, however, that there are limits on the extent to which it is possible to provide background analysis in all cases.

8.74 Approach to effectiveness measurement. As described in paragraph 8.27, our 1993 audit of effectiveness measurement in the Tax Policy Branch raised concerns about the adequacy of the resources dedicated to the function. We note that the Branch has recently taken action to increase the level of effort devoted to effectiveness measurement. The Branch started 1997-98 with 6.6 full-time-equivalent staff and a contract budget of \$250,000 allocated to the function. During the year, four additional analysts have been hired. In addition, the Department told us that the approach to evaluation has been changed so as to produce a greater number of short-term evaluations (including, but not limited to, tax expenditure evaluations) that will allow more timely reporting of results and a better-informed public debate on tax policy issues. These are welcome developments.

8.75 Our 1993 audit of effectiveness measurement in the Tax Policy Branch also raised concerns about the adequacy of the Branch's planning process in targeting priority areas for effectiveness measurement. We reported at that time that the Branch had developed a set of criteria to help select particular areas for effectiveness measurement but had not applied the criteria consistently and clearly. Our current audit confirmed that the criteria have been

maintained, and that they were applied in developing the Branch's evaluation plans for the 1995-97 period. We noted, however, that the implementation of these plans had fallen significantly behind the schedules established.

Legislative review processes need to be complemented by systematic measurement and reporting of effectiveness

8.76 Legislative provisions governing some policies and programs are subject to periodic review by Parliament to consider whether provisions should be changed to improve performance or to enable policies and programs to be adapted to changing circumstances. In many (but not all) cases, legislative reviews occur when legislation contains "sunset" provisions that terminate the legislation (usually after a period of five years); this ensures periodic parliamentary scrutiny of the legislation and of the policies or programs involved.

8.77 Many of the Department's areas of policy and program responsibility have been the subject of legislative reviews. We examined three specific reviews. Our aim was to identify the extent to which, in the course of the reviews, the Department of Finance informed Parliament about the objectives of the policies and programs and the extent to which those objectives had been achieved by existing approaches.

8.78 The legislative reviews we selected were of the equalization component of the Federal-Provincial Transfer Payments program, the regulatory regime for Canada's financial sector and the *Special Import Measures Act*. In all cases, the review process involved parliamentary scrutiny of proposals for change; we examined the effectiveness information that was available to support this parliamentary scrutiny.

8.79 **Equalization.** Chapter 8 of our 1997 Report (Department of Finance — Equalization Program) notes that little information is regularly provided to Parliament on the workings of the program. In particular, the Report states that the Department's Estimates documents have neither reported on the program's performance nor provided any indication of where parliamentarians can get such information.

8.80 As our 1997 Chapter 8 also notes, the review of equalization legislation is complicated by the provincial dimension. The process currently involves federal and provincial officials engaged in discussions behind closed doors, and there are concerns that Parliament is often not included in the deliberations in a timely fashion. The chapter calls for opening up this process for considering changes to such a complex, fundamental program by involving Parliament in a meaningful way.

8.81 The lack of regular reporting on program performance identified in our 1997 audit underlines the need for Parliament to receive information on program results within the context of the five-year cycle of legislative review and renewal. We therefore examined the information that the Department provided to Parliament to support the legislative review process leading to the 1994 renewal of the equalization legislation. We found that the information provided addressed some key aspects of the program's success in ensuring that provinces have sufficient revenue-raising capacity to provide reasonably comparable levels of public services at reasonably comparable levels of taxation. We believe that supplementing such information by considering a broader range of program effects (for example, possible inter-program effects in relation to other federal-provincial transfers) would further help support Parliament's involvement in the legislative review process.

8.82 **Regulatory framework for the financial sector.** We examined a range of documents to assess the role of effectiveness information in the legislative review of the regulatory framework for the financial sector. The material we examined included the recent audit work reported by this Office (Chapter 5, 1995 Report, Office of the Superintendent for Financial Institutions — Deposit-taking Institutions Sector), along with the Public Accounts Committee's report on that chapter and the Department's response. We also examined the Twenty-first Report of the Standing Senate Committee on Banking, Trade and Commerce (1995), and the Department's report (1997 Review of Financial Sector Legislation: Proposals for Change), along with relevant testimony and background documents.

8.83 Our 1995 Report indicated that although the government had produced several policy papers and reports dealing with different aspects of the regulatory framework, there had been no evaluation of the effectiveness of the framework to assess the extent to which its objectives had been achieved. In that Report, we noted that we had been unable to find a satisfactory answer to the question — Is the government achieving its objectives for the financial sector?

8.84 Following a hearing on our 1995 Report, the Standing Committee on Public Accounts in its Seventeenth Report, dated 20 November 1995, recommended that the government immediately carry out a comprehensive evaluation of the system for supervising and regulating federally regulated financial institutions. This was to be in preparation for the review of the legislation in 1997.

8.85 In its response to the Public Accounts Committee, the Department agreed that it was important to assess the relevance and effectiveness of existing systems and programs. However, the Department advocated a consultative review of the legislation rather than a program evaluation. It noted that, among other things, such a review would examine in more general and judgmental terms the effectiveness of the complex policy regime for the financial services sector than would a program evaluation. In addition, the Department stated that the complexity and rapid evolution of the financial sector would make it difficult to establish reliable empirical measures of the effectiveness of the regulatory framework. The Department also expressed the view that such measures of effectiveness would add little to the review process.

8.86 One conclusion of our audit is that, in terms of accountability to Parliament and Canadians in general, there is a strong case to be made for supporting legislative review processes with whatever information can be developed on the achievement of program objectives. This is so even if effectiveness measurement is not always able to produce definitive findings. In this case, we based our conclusion in large part on an examination of the Department's key report, 1997 Review of Financial Sector Legislation: Proposals for Change. This was an important consultative document in the context of the legislative review and represented the culmination of extensive prior work.

8.87 This report states that the message from the legislative review process is that the financial sector legislation is generally working well. However, the report provides no direct evidence to support this conclusion. In particular, the report does not explicitly identify the objectives of the regulatory framework and does not provide direct information on the extent to which objectives are being achieved. As noted, the Department stated in its response to the Public Accounts Committee that the rapid evolution of the financial sector, coupled with the short time that the legislation has been in place, makes measuring the achievement of specific program objectives difficult.

8.88 In our view, without developing and reporting effectiveness information to the extent possible, it is equally difficult to conclude as positively as the Department has done about the legislation's success. We believe it would be difficult for Parliament to assess the reliability of such a positive conclusion without clear evidence of the extent to which the objectives of the regulatory framework established under the legislation are being achieved, or an indication as to why such information cannot be provided.

8.89 The Department had in fact provided a preliminary assessment of the extent to which the regulatory framework was meeting its objectives in a background document to the deliberations of the Senate Standing Committee on Banking, Trade and Commerce. However, the Senate Committee concluded in its 1995 report that it was not possible to be certain at that point about the extent to which the regulatory framework was successful in achieving its objectives. The Department told us that its background material was instrumental in facilitating the Committee's deliberations and in shaping additional background work for the 1997 review of the legislation. We believe the Department's report on the 1997 review would have been more useful, both as a consultative document and as a means to provide accountability to Parliament, had it explicitly identified the regulatory framework's objectives and directly addressed their achievement.

8.90 The Department continues to be of the view that, because of the array of competing factors in the environment in which financial institutions and financial markets operate on a daily basis, the efficiency and effectiveness of the regulatory framework for the financial sector cannot be measured by evaluating discrete regulatory policies. It firmly believes that the sunset clauses in the financial institution statutes, which ensure that legislative reviews are conducted every five years, are the best mechanism to keep Parliament informed of the performance of the financial sector in relation to broad policy objectives. The Department notes that these reviews involve widespread consultations with stakeholders who provide considerable feedback on how the broad policy objectives are being met and what areas need to be addressed.

8.91 In December 1996, the Minister of Finance announced the establishment of a Task Force on the Future of the Canadian Financial Services Sector. This initiative is part of the government's effort to ensure that the regulatory framework for the sector keeps pace with the changing environment in which it operates. The Task Force's enquiries extend broadly to the public policies affecting the sector and its report is to be submitted to the Minister of Finance by September 1998. At the present time, therefore, the extent to which its work will involve measuring and reporting on the effectiveness of the current regulatory framework is not known.

8.92 **The *Special Import Measures Act*.** The *Special Import Measures Act (SIMA)* provides for the application of anti-dumping and countervailing duties on dumped or subsidized imports that are found to cause material injury to domestic producers. The Act was subject to legislative review in 1996 by the House of Commons standing committees on Finance and on Foreign Affairs and International Trade.

8.93 The decision to proceed with a legislative review was prompted, in part, by the findings from Chapter 19 of our 1992 Report, Department of National Revenue — Customs and Excise — Special Import Measures Act. In that audit, we noted that the Department of Finance, the department responsible for policy and legislation, had not completed an evaluation of the program since the Act came into force in 1984. We pointed out the need to measure the impacts and effects of the *SIMA* program, including both positive effects and possible negative effects, such as the extent to which protection may be detrimental to consumers, possibly increasing production costs and the ultimate prices of consumer goods. We recommended, among other things, that the Department complete a formal evaluation of the import policy framework. In its response published in our Report, the Department agreed with the recommendation.

8.94 In view of the Department's commitment, in this audit we examined background material prepared by the Department of Finance to assist the parliamentary committees during the 1996 legislative review. We found that the Department had provided a wide range of material, including some relating to the experience of other countries, with respect to the incidence, design and implementation of special import measures. As part of this material, the Department discussed the general impacts of these trade remedies, but provided no measurement of the actual extent of the impacts on Canadian consumers or on the Canadian economy as a whole.

8.95 Our examination of the joint report of the parliamentary committees that carried out the 1996 legislative review showed that the process led to important assessments of the continued relevance of the program and ways in which its operational design could be improved. In terms of the recommendations we made in 1992, however, we believe the *SIMA* legislative review would have benefited further if the Department had addressed more directly the effectiveness measurement concerns we raised at that time. This would have provided Parliament with a clearer perspective on the impacts of the program. The Department indicated that the Minister chose to have the legislation reviewed by a parliamentary committee.

8.96 Our assessment of the three cases described above confirmed that legislative reviews have many strengths — including timeliness and transparency. We concluded, however, that they need to be complemented by specific effectiveness measurement and reporting processes. Separate processes are required to provide Parliament with timely information on the results that policies and programs are achieving relative to their objectives. In addition to serving accountability, we believe such information enhances the quality of legislative reviews by leading to better-informed public and parliamentary debate on performance issues and helping assess the need for change.

Effectiveness Measurement Capacity and Corporate Planning

8.97 As noted earlier, the findings of this audit and previous audits carried out by our Office point to insufficient attention being given to effectiveness measurement and reporting by the Department. We assessed the commitment to effectiveness measurement and to providing Parliament with accountability information on results by examining the recognition given to it in the Department's corporate planning and identifying the resources allocated to the function.

Effectiveness measurement is not sufficiently integrated with the Department's overall corporate planning

8.98 In organizations that manage for results, effectiveness measurement is usually closely linked with corporate planning for the organization as a whole. In this way, effectiveness measurement becomes a matter of concern at the highest levels within the organization. The findings of previous evaluations and reviews can be used to help develop the priorities and strategies set out in corporate plans. At the same time, plans and priorities for future effectiveness measurement efforts can be established consistent with overall corporate strategies and plans.

8.99 In the policy and program areas we examined, effectiveness measurement is not clearly identified as an element in the Department's overall corporate planning.

8.100 We found that only the Tax Policy Branch has made efforts to plan its effectiveness measurement activities systematically, taking account of the Department's upcoming corporate priorities and the accompanying need for information on program results.

8.101 **The Department of Finance should ensure that there are clear links between its overall corporate planning process and its effectiveness measurement function.**

Department's response: It is already the case that effectiveness measurement is an overall part of the corporate planning process. Effectiveness measurement pervades the work of the Department and is intrinsic to what the Department does. In this way, the linkage between effectiveness measurement and the corporate planning process is established and maintained. This was demonstrated by examples such as the Tax Fairness document published as part of the 1996 Budget.

The Department's approach to effectiveness measurement needs to be strengthened

8.102 We are concerned about the Department's capacity to meet its responsibilities for effectiveness measurement and reporting. The Department has responsibilities for measuring and reporting on the effectiveness of federal tax policies as well as policies and programs involving \$66 billion in annual expenditures. We could identify, at most, about 14 full-time-equivalent staff, and less than \$300,000 in annual contract budgets, that were specifically allocated to effectiveness measurement.

8.103 We noted that in contrast with the Department of Finance, Human Resources Development Canada, with approximately \$55 billion in annual expenditure programs, currently has over 30 full-time-equivalent staff and approximately \$7 million in contract resources for effectiveness measurement. We recognize that any comparisons have to be treated with considerable caution because of differences in the nature of the policies and programs involved. However, we believe that the striking difference in resource allocation raises questions about the adequacy of the Department of Finance's capacity to measure and report on the achievement of objectives in those areas where it has direct policy or program responsibilities.

8.104 Clearly identified effectiveness measurement resources are currently located in two of the Department's branches — the Tax Policy Branch and the Financial Sector Policy Branch. In the former, specific full-time-

equivalent staff resources are identified; in the latter, effectiveness measurement activities are carried out largely under contract. No resources are specifically allocated to effectiveness measurement activities in the three remaining policy and program branches. Two of these (Federal–Provincial Relations and Social Policy, and International Trade and Finance) have clearly identified policy and program responsibilities. The Federal–Provincial Relations and Social Policy Branch noted, however, that it devotes significant resources to reviewing the Canada Pension Plan and to assessing how accurately the Equalization Program formula measures provincial fiscal capacities — which it sees as a key indicator of the program’s effectiveness.

8.105 Whatever the Department’s capacity to plan and undertake effectiveness measurement, an equally important question is whether that capacity is organized within the Department to maximize its potential contribution.

8.106 We expected that the organization of the effectiveness measurement function would reflect its importance as a key tool for management and for providing accountability to Parliament. As such, the function would be designed to ensure objective, independent and timely analysis, and would be organized in a way to sustain its role and importance within the overall departmental structure.

8.107 We found that the Department’s current approach to effectiveness measurement results in a function that is partial in coverage and not well integrated with the overall corporate management structure. The function is clearly identifiable within only a limited number of the Department’s policy and program branches that form the “front–line” of its activities.

8.108 Approaches to effectiveness measurement in other organizations. For purposes of comparison, we looked at selected characteristics of some organizations where we were told that effectiveness measurement and reporting play prominent and positive roles. The organizations we selected were the World Bank, the International Monetary Fund and Human Resources Development Canada.

8.109 We selected the first two because of the key role that results information, analysis and reporting play in their operational activities. We included Human Resources Development Canada because the Department has announced that it is developing a results–driven accountability system.

8.110 In making comparisons between the effectiveness measurement functions in these organizations and the Department of Finance, we focussed on three areas: the organizational structure of the effectiveness measurement function; the attention given to effectiveness measurement in corporate planning; and the reporting of results.

8.111 The results of our analysis are summarized in Exhibit 8.8. All the comparison organizations, while diverse in nature, have a great deal in common with respect to how the function is treated.

Exhibit 8.8

Comparison of Approach to Effectiveness Measurement with Other Organizations¹

	Department of Finance	International Monetary Fund	World Bank	Human Resources Development Canada
Organizational Structure of Effectiveness Measurement Function	<ul style="list-style-type: none"> - Partial Effectiveness measurement not a clearly identified function in most Branches - Function does not report to Deputy Minister or to senior management committee 	<ul style="list-style-type: none"> Comprehensive/ Strategic - All operational groups undertake review of objectives achievement - Further recognition of need for accountability and transparency with newly established evaluation unit reporting to Managing Director - External evaluation as a “second opinion” 	<ul style="list-style-type: none"> - Comprehensive/ Strategic - Operational groups subject to process evaluations reported to senior management - Separate evaluation unit examines long-term impacts (work in progress); reports to Board of Directors 	<ul style="list-style-type: none"> - Comprehensive/linked to “results-driven accountability system” and legislative requirements - Separate evaluation unit reports to senior management committee; does not report directly to Deputy Minister
Corporate Planning and Program Effectiveness Measurement	<ul style="list-style-type: none"> - Effectiveness measurement not identified as an element of Corporate Business Plans - Department states it will react if requested by Parliament to produce effectiveness results for specific programs but does not take initiative 	<ul style="list-style-type: none"> - Central part of Corporate Planning 	<ul style="list-style-type: none"> - Central part of Corporate Planning 	<ul style="list-style-type: none"> - Important part of corporate planning through “results-driven accountability system”
Reporting of Results	<ul style="list-style-type: none"> - Limited reporting 	<ul style="list-style-type: none"> - Transparent reporting vis-à-vis Executive Board representing member countries 	<ul style="list-style-type: none"> - Transparent reporting of operational effectiveness - Growing focus on measurement/reporting of long-term impacts from programs 	<ul style="list-style-type: none"> - Transparent reporting

¹ Information on the International Monetary Fund, World Bank and Human Resources Development Canada is based on published material and interviews. We did not carry out audit work in these organizations.

Source: Office of the Auditor General

8.112 In all three organizations, the effectiveness measurement function is comprehensive in its coverage and strategic in focus. Further, in each, the function reports either organizationally or functionally at the highest level within the organization. In contrast, we assessed effectiveness measurement in the Department of Finance as partial in program coverage, excluding important program areas, and not closely connected to the highest levels within the organization.

8.113 The Department’s response to effectiveness measurement and reporting requirements is reactive rather than strategic. The Department has on occasion responded to audit findings concerning shortcomings in effectiveness measurement and reporting by indicating a willingness to undertake measurements in specific areas if directly requested to do so by Parliament. This response presupposes that Parliament can assess beforehand, and without adequate information, the degree of importance that should be accorded to various program or policy outcomes. In our opinion, this is unrealistic.

8.114 Further, as noted earlier, the function is not clearly identified as an element in the Department's overall corporate plans. In contrast, effectiveness measurement figures visibly in the corporate planning processes of the three comparison organizations and is a significant factor in their management and accountability regimes. There is increasing emphasis in these organizations on the reporting of results achieved relative to program objectives.

8.115 **The Department of Finance should ensure that its approach to effectiveness measurement is consistent with the need to maximize its contribution to meeting the Department's obligation to account to Parliament for results.**

Department's response: Both effectiveness measurement and reporting are part of the everyday work of the Department of Finance and are an essential part of the basic mandate of the Department. Work done in the Department that takes the form of analysis, review and ongoing monitoring (e.g. the Excise Act Review and the CPP Review) is ignored, even though the audit recognizes these as legitimate forms of effectiveness measurement. The Department prints evaluation information in a variety of forms, including Budgets, consultation papers, press releases, etc., but the chapter takes almost no account of these.

Conclusion

8.116 The Department of Finance has wide-ranging policy and program responsibilities, involving tens of billions of dollars in expenditures and tax revenues. The significance and size of these policies and programs place particular importance on effectiveness measurement and reporting to provide accountability to Parliament and Canadians as well as to help improve program performance.

8.117 We found that systematic measurement of effectiveness relative to policy and program objectives, and public reporting to account for the achievement of objectives with the funds and authorities approved by Parliament are limited.

8.118 Priorities and plans for effectiveness measurement are not established within the context of the Department's corporate planning process, and the resources allocated specifically to the function are limited. Overall, we found the function to be partial in coverage and not clearly integrated with the overall corporate management structure.

8.119 In view of government policy and Parliament's expectations for improved information on results, we believe that the Department needs to review the options available to it for strengthening effectiveness measurement and reporting and then select and implement the most appropriate option.

Department's overall response: In responding to the conclusions of this audit, there are two general comments to be made.

- *First, the Department does undertake a considerable number of evaluations but they are ignored because the audit takes much too narrow and mechanistic a view of what effectiveness measurement and reporting are. This is because of the audit's singular focus on so-called "formal evaluations" — detailed, longer-term, major research undertakings — to the virtual exclusion of any other type of effectiveness measurement, which could be relatively short, but equally effective. Examples of the latter are the analyses, presented in Budget chapters, underlying the basis for a change in policy.*
- *Second, the audit raises the question of whether the Department should do more "formal evaluations". In answering that question, it must be recognized that to do so would require diverting resources away from other policy analysis and development and less formal evaluations. In striking the balance between "formal*

evaluations” and other critical work, the Department must be guided by the principle that Canadians must get “value for money”. Disturbing this balance would imply going counter to this fundamental principle.

As the examples in the Department’s responses to specific recommendations in the chapter make clear, it would appear that a whole range of evaluations has escaped the attention of the auditors.

About the Audit

Objectives

The objectives of our audit were:

- to determine the extent to which the Department of Finance undertakes effectiveness measurement and reports publicly on the achievement of objectives in those areas where it has direct responsibilities related to policies and programs; and
- to determine the extent to which the Department has the capacity, structures and procedures to measure adequately, and report publicly, on the effectiveness of its policies, programs and operations.

Scope

Our scope included components of all the Department's major policy and program areas except those that relate to privatizing certain Crown corporations, to the Special Program (payment of Canada's equity interest in the Hibernia oil development), and to Domestic Coinage (production and shipment of coins). The estimated 1997–98 expenditures for the programs we excluded represent less than one percent of the Department's total expenditures.

With the exception of the Tax Policy Branch, our audit covered the period from 1992 to 1997. In the case of the Tax Policy Branch, we followed up on a special 1993 audit of the changes that had been introduced in the organizational approach to effectiveness measurement in that Branch.

Criteria

The Department of Finance should have in place procedures and practices that enable it to:

- identify and communicate to Parliament the nature and extent of its policy and program-related responsibilities;
- inform Parliament clearly and consistently of the objectives of the policies, programs and operations for which it is accountable;
- measure program effectiveness to produce accurate, reliable and timely assessments of results achieved relative to objectives;
- report publicly on effectiveness;
- maintain a capacity for effectiveness measurement and reporting commensurate with its obligation to account to Parliament for results;
- organize the effectiveness measurement and reporting function to ensure objective, independent and timely analysis, and to sustain the function and its role; and
- integrate the planning of effectiveness measurement with its corporate planning processes.

Approach

The audit focussed on the measurement and reporting of effectiveness in those areas where the Department has direct policy and program-related responsibilities. We placed particular emphasis on public reporting because of the need for Parliament and the public to be informed clearly and regularly of the results of policies and programs, as well as of the nature and extent of the Department's accountability for them.

We sent a questionnaire to departmental branches with direct policy and program-related responsibilities. The questionnaire was designed to obtain information on those responsibilities, the planning and organization of effectiveness measurement, and effectiveness measurement undertaken and publicly reported. We conducted interviews with departmental officials to obtain further information and clarification. In addition, we examined the Department's submissions to Parliament in Part III of the Main Estimates for the period 1991-92 to 1997-98, government Budget Papers produced during the same period, departmental submissions to standing committees, and White Papers and legislative review reports.

Finally, we reviewed material on effectiveness measurement activities of other organizations and interviewed selected individuals from those organizations.

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Chapter 9

Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards

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Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards

Main Points

9.1 The 1980s and early nineties have seen major advances in financial reporting by sovereign governments, with Canada among the leaders. However, over the past two years the Government of Canada has begun departing from both objective accounting standards and its own stated accounting policies for certain transactions. Moreover, the 24 February 1998 Budget indicates that a similar departure will occur in 1998.

9.2 In 1996, transitional assistance for harmonizing PST with GST was included in the deficit even though provinces had not yet agreed to the harmonization by the end of the year. In 1997, funding of the Canada Foundation for Innovation was included in the deficit even though the Foundation did not exist by the end of the year. In 1998, the 24 February 1998 Budget indicates that funding of the Canada Millennium Scholarship Foundation will be included in financial results whether or not the Foundation exists by the end of the year.

9.3 As auditors of the government's financial statements, we are deeply concerned over this recent disregard by the government for objective accounting standards in reporting its financial results to Parliament and to Canadians. This is not merely a technical disagreement between an accountant and an auditor. Objective accounting standards are accepted and identifiable standards that are established by an arm's-length standard-setting body - the Canadian Institute of Chartered Accountants (CICA). Business firms cannot depart from objective accounting standards established by the CICA, to hide losses or to hide profits. Parliamentarians should expect no less from the government.

9.4 Meeting the significant challenges of the next decade will require, among other things, credible annual reports by the government on its overall financial health. In our view, departures from CICA standards and the government's own accounting policies must cease if credibility is to be restored to the reports that parliamentarians and others need.

9.5 Accordingly, we have recommended that the Government of Canada ensure that its accounting policies and practices conform with recommendations issued by the CICA's Public Sector Accounting and Auditing Board. Implementation of this recommendation will require continued diligence by the Public Accounts Committee of the House of Commons in reviewing the government's annual financial statements.

9.6 Although this chapter calls Parliament's attention to inappropriate accounting, there are related concerns that we have and will continue to report separately. They deal with accountability and parliamentary oversight for entities such as the Innovation Foundation and the Millennium Scholarship Foundation, and with whether or not such entities are, in substance, operating at arm's length from the government.

Introduction

9.7 Each year, the Government of Canada reports its financial results in the *Public Accounts of Canada*. Specifically, Section 1 of Public Accounts Volume I contains government-wide financial statements that this Office is required to audit and report on under section 6 of the *Auditor General Act*. The overall framework for reporting financial results, as described in this chapter, is depicted in Exhibit 9.1.

Exhibit 9.1 is not available, see the Report

Framework for Reporting Financial Results in the Government of Canada

9.8 Our audit of the government's financial statements is carried out to express an opinion on whether the financial statements present information fairly. By performing our audit, we also enhance the credibility of reported financial results. If we find that the financial statements present information fairly, we say so by expressing what is called a "clean" opinion. However, if we have reservations about the financial statements, we give what is called a "qualified" opinion and explain our reservations. Unfortunately, our opinion on the government's 1997 financial statements was qualified for the reason described in paragraphs 9.26 to 9.31.

9.9 The purpose of this chapter is to call Parliament's attention to this recent problem with the financial statements that, if not corrected, could lead to an inappropriate picture of financial results and to qualified audit opinions for some years to come.

Observations and Recommendation

The Need for Objective Accounting Standards

9.10 In the public sector, we believe that there is a fundamental principle of accountability that requires governments to report financial information to legislatures in such a way that citizens can rely on the credibility of the information provided. This principle of credibility applies equally to private sector organizations when preparing financial statements for their readers.

9.11 For financial statements to be credible, readers need to have confidence that the statements follow some accepted and identifiable standards that are established by an arm's-length standard-setting body. Throughout this chapter, these are referred to as **objective accounting standards**. These standards cannot be subject to the individual preference of the financial statement preparer.

9.12 For example, a reader may wish to compare the financial statements of the federal government with those of a particular province, or to compare the financial statements of the same level of government over time, even though they may have been prepared by different governments drawn from different political parties. If individual governments of the day are free to choose whatever accounting policies and practices they wish, readers will have no confidence that the financial statements are consistent or comparable over time. And without such confidence, the credibility of all financial statements is compromised.

9.13 Financial statement preparers, indeed their auditors, may have their own ideas as to what accounting standards should say — they might prefer that a particular standard be different from what was promulgated and there may be good theoretical arguments for alternative viewpoints. But that is why, as described in Exhibit A.1 of the Appendix to this chapter, the processes for developing accounting standards provide ample opportunity to express individual points of view. Once the standards are promulgated, however, individual preferences must be

submerged. And it follows that the standard-setting body must be at arm's length from the financial statement preparer — otherwise, the standards could be changed arbitrarily from year to year to suit the current preferences of management.

9.14 In the private sector, there are additional reasons for following objective accounting standards. Business firms who wish to sell debt or equity securities to the investing public must not be able to exaggerate financial results by devising and using accounting policies and practices to hide losses. Similarly, firms who wish to minimize taxes or dividends must not be able to use policies and practices that hide profits.

9.15 Therefore, in order to guard against distortions of this type and to achieve credibility, the *Canada Business Corporations Act* requires all federally chartered public companies to prepare their financial statements in accordance with Generally Accepted Accounting Principles established by the Accounting Standards Board of the Canadian Institute of Chartered Accountants, or GAAP, as these principles are often referred to.

9.16 The consequences of not complying with GAAP could be very serious for a business firm. The reason is that the firm's auditors would be obliged to state in their opinion that GAAP had not been followed, which would send a clear signal to readers of the financial statements that the reported results were not credible. Further, Canadian securities regulatory authorities take a very dim view of qualified opinions. As a result, in the private sector one rarely sees financial statements departing from GAAP. Management cannot tolerate the negative consequences of a qualified opinion and will generally comply with GAAP to avoid it.

9.17 Parliamentarians and the Canadian public should expect no less from the federal government. And yet results frequently were inappropriately reported in the government's financial statements from the late 1970s through the end of the 1980s, as described in the Appendix to this chapter. This unfortunate situation occurred because there were no arm's-length standards of recommended accounting to which both the government and our Office could refer. It was therefore difficult for readers of the government's financial statements to have confidence that a consistent and fair presentation was being given to them. During debates in the House of Commons at the time, the government described the situation as an "honest division of opinion" between two experts on technical accounting matters, and said that it could "list a number of accountants who will argue one side of this issue and a number who will argue the other side."

9.18 Fortunately, since that time, objective accounting standards for Canadian governments have substantially been developed and published by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. Additional information on the activities and outputs of PSAAB is provided in the Appendix to this chapter. As also noted in the Appendix, the government has substantially brought its accounting policies in line with PSAAB standards, as encouraged by the Public Accounts Committee.

Recent Departures from Objective Accounting Standards

9.19 Over the past two years, however, the federal government has begun departing from both objective accounting standards and its own stated accounting policies for certain transactions. These transactions are part of "transfer payments", which comprise approximately 50 percent of the government's expenditures. Some of the more significant transfer payments made by the government are for old age security benefits to individuals, and the Canada health and social transfer to provinces.

9.20 "Transfer payments", often called grants and contributions, are payments in return for which the government receives no goods or services directly. Because transfer payments comprise such a significant portion of public sector expenditures, PSAAB has published recommendations on accounting for them.

9.21 The government's stated accounting policies adhere to those recommendations. Note 1 to the government's annual financial statements states, "Transfer payments are recorded as expenditures when paid or when the recipient has fulfilled the terms of a contractual transfer agreement."

9.22 Unfortunately, the government has not followed this policy when accounting for certain significant transfer payments in each of the past two years. Moreover, the 24 February 1998 Budget indicates that a similar departure will occur in 1998.

The 1996 problem: harmonizing GST and PST

9.23 In 1994, the government began a series of discussions with provinces to streamline and simplify the operation of Canada's value-added tax system. The proposal was to harmonize the federal goods and services tax (GST) with provincial sales taxes (PST). In late March of 1996, the government made a formal offer to the provinces of Newfoundland and Labrador, Nova Scotia and New Brunswick to provide transitional assistance totalling \$961 million, payable when they entered into a detailed agreement to harmonize their PST with the GST. In early April of 1996, the three provinces agreed to continue negotiations, and memoranda of understanding (MOUs) were signed. The MOUs called for agreements to be negotiated and in place within six months, for enabling legislation to be enacted by Parliament and each provincial legislature and for harmonization to commence on 1 April 1997. The amount of transitional assistance was based on a formula, and officials advised that it was not subject to revision. As disclosed in Note 4(v) to the government's 1996 financial statements, the transitional assistance of \$961 million was recorded as a liability at 31 March 1996, and as an expenditure and resultant increase in the deficit for that fiscal year.

9.24 At the time of finalizing the 1996 financial statements and our opinion on them, negotiations were still continuing between the three provinces and the government. Matters outlined in the MOUs were still under discussion, such as the definition of the common tax base, mechanisms to tax interprovincial transactions, and the number of provincial employees who would be employed by the government to administer the harmonized taxes. In addition, although federal legislation to authorize the transitional assistance of \$961 million was tabled in Parliament on 23 April 1996 and received royal assent on 20 June 1996, enabling legislation for the three provinces had not yet been introduced in their respective legislatures.

9.25 Therefore, at 31 March 1996 the recipient provinces had not fulfilled the terms of a contractual transfer agreement. The agreements to harmonize were not signed and in place until more than six months after the close of the 1996 year. And yet the government recorded the transaction as if the agreements had been signed and in place at 31 March 1996. This represents a significant departure from the government's own accounting policies.

The 1997 problem: the Canada Foundation for Innovation

9.26 In the 18 February 1997 Budget, the government announced its intention to establish the Canada Foundation for Innovation. The Foundation would be operated independently of government through a board of directors, a majority of whom would be drawn from the private sector and research and academic communities. The Foundation's purpose is to combine government and private sector funding to enhance education and research infrastructure at post-secondary institutions and research hospitals. The government stated that the Foundation would be funded by an up-front investment of \$800 million. This transaction was recorded in the government's 1997 financial statements as if it were a liability, and was charged to the deficit of that year.

9.27 Legislation to implement certain provisions of the 1997 Budget was not given first reading in the House of Commons until 9 April 1997, and the *Budget Implementation Act, 1997* did not receive royal assent until 25 April 1997. Part I of the Act established the Foundation and Part XI provided parliamentary authority for the payment of \$800 million plus interest to the Foundation.

9.28 A funding agreement between the Foundation and the government was not signed until 2 July 1997, and the \$800 million (plus interest of \$964,000) was not paid to the Foundation until that date. Among other things, the funding agreement sets forth the terms and conditions under which the Foundation shall both administer and invest those funds and determine to whom it shall disburse those funds. At the time of writing this chapter, no disbursements had yet been made to eligible recipients.

9.29 One key element of the government's own accounting policies is that for a transfer payment to be included in financial results, a "recipient" must exist. In this case, at 31 March 1997, there was no recipient to which the Government of Canada owed \$800 million. The recipient, that is the Foundation, was not created until 25 April 1997 when the *Budget Implementation Act, 1997* received royal assent.

9.30 A second key element of the government's own accounting policies is that for a transfer payment to be included in financial results, the recipient must have fulfilled the terms of a contractual transfer agreement. In this case, the funding agreement setting out these terms was not signed until July 1997.

9.31 Nonetheless, the government recorded the transaction as if the recipient had existed at 31 March 1997 and the funding agreement had been in place at that time. This was the second year in a row that the government departed from its own accounting policies.

The 1998 problem: the Canada Millennium Scholarship Foundation

9.32 In the 24 February 1998 Budget, the government announced its intention to create the Canada Millennium Scholarship Foundation. The Foundation will be managed by a board of directors, at arm's length from the government. The Foundation's purpose is to provide scholarships annually to Canadians from low- and middle-income families for post-secondary education.

9.33 The government stated that it will provide an initial endowment of \$2.5 billion to the Foundation. An endowment, similar to the funding of the Canada Foundation for Innovation in 1997, is a transfer payment (defined in paragraph 9.20). This transaction will be recorded in the government's 1998 financial statements as if it were a liability, and will be included in the financial results of that year.

9.34 The Budget documents said that legislation to establish the Foundation would be introduced in the House of Commons shortly after the Budget date. At the time of writing this chapter, officials had advised us that it was highly unlikely that this legislation would be passed by 31 March 1998. After the legislation has passed, the Foundation's board members will be appointed and a funding agreement signed that sets forth the terms of investing the endowment and disbursing it to eligible recipients. Officials advise us that this will not occur until well after 31 March 1998. Scholarships will not be awarded to eligible recipients until the year 2000.

9.35 Neither of the key elements in the government's own accounting policies — the legal existence of a recipient or the fulfillment of the terms of a contractual transfer agreement — will have been met by 31 March 1998. Nonetheless, indications are that the government intends to record this \$2.5 billion transaction as if they had. This will therefore represent the third year in a row that the government has departed from its own accounting policies for transfer payments.

The government's rationale for these departures

9.36 The government believes that it should take financial accountability — reflected in its financial results — for its decisions to incur expenditures for transfer payments in the year those decisions are taken. The government also believes that transparency is achieved by providing full disclosure of such transactions in the Budget and the financial statements.

9.37 While these views may have some intuitive appeal, they do not conform with objective accounting standards. Under such standards, the announcement of an intention to make payment is more in the nature of a “commitment”. Commitments are reported in notes to financial statements, but are not reflected in financial results. This prevents management from influencing reported results by simply announcing a decision toward the end of a particular year to spend money in some future year. Annually, the government reports tens of billions of dollars in commitments in notes to its financial statements but does not reflect them in its financial results.

9.38 In the 24 February 1998 Budget, the government states, “Non-recurring liabilities will be recognized in the year in which the decision to incur the expenditure is made, provided the enabling legislation or authorization for payment receives parliamentary approval before the financial statements for that year are closed.” If the government changes its accounting policies for transfer payments in this manner, those policies will no longer conform with the recommendations of PSAAB. In our view, non-conformance with PSAAB is as serious an issue as departures from the government’s own accounting policies.

9.39 **The Government of Canada should ensure that its accounting policies and practices conform with recommendations issued by the Canadian Institute of Chartered Accountants’ Public Sector Accounting and Auditing Board.**

Treasury Board Secretariat’s response: It is the government’s view that its accounting policies and practices generally conform in substance to recommendations of the Canadian Institute of Chartered Accountants (CICA). The government believes its decisions and public announcements to provide funding to arm’s-length organizations such as the Canada Foundation for Innovation establish liabilities that should be recorded in the years in which the decisions are made. These liabilities meet the definitions of both equitable and constructive obligations as defined in the CICA Handbook and reflect substance over form. In addition, the government believes that transparency and accountability are best served by recording these liabilities in the year in which the government made its decision to incur them.

Related Concerns

9.40 We have related concerns regarding entities such as the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation. One of these concerns, which revolves around issues of accountability and parliamentary oversight, is elaborated upon in Chapter 36 (paragraphs 36.48 to 36.54) of our December 1997 Report. It relates to the fact that the Canada Foundation for Innovation is not obliged to report on the results it achieves with \$801 million of public money and that Parliament may consequently have difficulty obtaining the information it needs on this kind of expenditure.

9.41 A second concern relates to what we would call the essential nature or substance of these types of entities. We will be examining this matter further and will report separately if significant findings emerge. Questions that we will address in this study will include whether, in substance or in fact, such entities operate at arm’s length from the government.

Conclusion

9.42 The purpose of this chapter has been to call Parliament’s attention to a recent departure from objective accounting standards and the government’s own accounting policies for recording transfer payments. By not following objective accounting standards — accepted and identifiable standards that are established by an arm’s-length standard-setting body — the government puts the credibility of its financial statements into question. We believe that implementing our recommendation would resolve this recent problem and would restore the credibility of government-reported financial results.

9.43 Implementing this recommendation will require continued diligence by the Public Accounts Committee in reviewing the government's annual financial statements to help ensure that objective accounting standards are followed.

About the Study

Objective

Our objective was to call Parliament's attention to a recent problem with the financial statements of the Government of Canada that, if not corrected, could lead to an inappropriate picture of financial results and to qualified audit opinions for some years to come.

Scope and Approach

This study is based on the research of existing literature as follows :

- Section 1, Volume I of the 1996 and 1997 Public Accounts of Canada and certain sections of the Public Accounts of Canada from 1979 to 1994
- 24 February 1998 Budget
- Recommendations of the Canadian Institute of Chartered Accountants Public Sector Accounting and Auditing Board
- Recommendations of the Public Accounts Committee of the House of Commons
- Recent activity in government-wide financial reporting across the world

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Appendix A

Additional Background Information

Introduction

This appendix provides additional background information on the Government of Canada's annual financial statements.

Throughout the 1980s, the credibility of the government's annual financial statements improved considerably. By 1990, the Auditor General was finally able to provide an audit opinion without reservation — a “clean opinion”. Two critical factors helped bring this about. First, the Public Accounts Committee (PAC) of the House of Commons reviewed the financial statements frequently and encouraged the government to improve them. Second, authoritative standards of recommended accounting and reporting practice were developed to which both the Comptroller General and the Auditor General could refer in assessing fairness.

The 1990s brought further improvement. A concise annual financial report was published to help make reported results more understandable. Also, indicators of financial condition were developed to help make reported information more useful. Internationally, the government of New Zealand began publishing audited government-wide financial statements and Australia and the United States are planning to follow suit. In addition, two international bodies — one auditing and the other accounting — began publishing guidance on accounting and financial reporting for governments around the world.

The Evolution of the Government of Canada's Financial Statements

Virtually since Confederation, the Government of Canada has prepared and published an annual report on financial matters, entitled *The Public Accounts*. Until quite recently, the *Public Accounts* were primarily concerned with reporting: the use made by the government of authorities granted by Parliament to spend, borrow and raise revenues; analyses of revenues, expenditures, assets and liabilities; listings of individual transactions of interest to parliamentarians; and related commentary. This is important accountability information in the public sector and it continues to be included in the *Public Accounts* to the present day.

Prior to the mid-1970s, statements of assets and liabilities and of revenues and expenditures were presented in separate sections of the *Public Accounts*, following considerable detailed analysis and commentary. Each of these two statements contained a “certificate” by the Auditor General reporting that they exhibited a correct view, subject to comments in his annual report to the House of Commons. There were two problems with this type of reporting. First, a summary financial overview of the government was not presented in one place and the information that was reported was buried within massive amounts of detail. Second, in order to determine whether the Auditor General was satisfied with the statements, readers had to consult a separate report — the Auditor General's annual report — and be able to assess whether comments there affected the fairness of the statements.

Throughout the remainder of the 1970s, significant changes were made to the presentation and audit of the government's summary numbers. The financial statements were moved to the front of the *Public Accounts* and presented together in one section. Footnotes were included in this section to explain the basis of accounting used in preparing the statements and to provide other explanatory information. The Auditor General's annual opinion on the fairness of the statements was also included in this section.

By 1980, the government's financial statements were more visible and the Auditor General's opinion was more understandable. However, the statements continued to be prepared on an accounting basis that mirrored legislative

authorities to spend, borrow and raise revenues. This accounting basis was not necessarily appropriate for reporting the government's overall financial position and operating results. For example, it resulted in over \$4 billion of liabilities being excluded from the accounts and over \$3 billion of money the government owed to itself being shown as assets. Clearly, there was a need for a more appropriate basis of accounting for the annual financial statements.

In the early 1980s — with support and encouragement from the PAC, the government and our Office — the Canadian Institute of Chartered Accountants (CICA) formed a Public Sector Accounting and Auditing Board (PSAAB) to develop accounting and financial reporting standards that could be recommended to Canadian governments. Throughout the 1980s and well into the 1990s, the PAC held a number of hearings to consider issues raised by our Office on the fairness of the financial statements; PSAAB developed and recommended a number of important standards; and the government implemented major reforms to the form and content of its financial statements.

In addition, commencing in 1994, the government began publishing condensed financial statements in a concise user-friendly annual financial report not unlike reports published by corporations in the business world. This separate document is published before the Public Accounts, and includes our audit opinion on the condensed financial statements included therein. And just last year, the CICA published a research study that called on Canadian governments to report their overall financial condition through a set of 10 “simple indicators”. The government's concise report and the CICA's 10 indicators represent major contributions to governments within Canada and abroad who are trying to make overall financial reporting more understandable and more useful to legislators and citizens.

The following two sections of this appendix elaborate on the work of PSAAB to develop objective standards of recommended accounting and reporting practice, and on the key role played within Canada by the PAC.

The Development of Objective Standards of Recommended Accounting and Reporting Practice in Canada

In 1978, the Auditor General began giving a concise audit opinion on the federal government's annual financial statements as required by section 6 of his new Act. What made this task particularly difficult, for both auditor and preparer, was that there were no standards of recommended accounting and reporting practice to which each could refer. As a consequence, the whole exercise was quite subjective and not as useful as it should have been for members of Parliament and Canadians generally.

In these early years, the preparer (the Office of the Comptroller General) and the auditor (the Office of the Auditor General) simply could not agree on how the summary numbers should be shown to present fairly the government's overall financial position and operating results. When it came time to report on the financial statements, the Auditor General felt obliged to issue audit opinions with several significant reservations. When the Public Accounts were tabled in the House of Commons with these very negative opinions, parliamentarians became quite vocal during Question Period. One year, after listening to heated discussion, the then-Minister of Finance rose and explained that in his view, the issue was simply an “honest division of opinion” between two experts on technical accounting matters. The Minister went on to say, “We can list a number of accountants who will argue one side of this issue and a number who will argue the other side.” And at that, the issue died. The Auditor General believed that the summary numbers were not presented fairly, but he was unable to say so persuasively because he had no credible standards to refer to. Parliamentarians and other users of the financial statements were put in the unfair position of having to determine who was right, the preparer or the auditor.

In 1981, the CICA created PSAAB to provide these standards, after carrying out an extensive, in-depth study of the accounting and financial reporting practices of Canadian federal and provincial governments. That study showed that individual governments accounted for the same transactions in very different ways, making it virtually impossible to make any meaningful government-to-government comparisons. In addition, the information

presented in government financial statements was fragmented and incomplete — to the point of misleading users. Major liabilities went unrecorded, financial assets were overvalued and debts were accumulated in subsidiary organizations that were not included in governments' financial statements.

The objective of PSAAB is to recommend standards to improve and harmonize financial reporting, accounting and auditing in the “public sector”. As stated in the introduction to PSAAB’s recommendations, “public sector” refers to federal, provincial, territorial and local governments, government organizations jointly owned or controlled by two or more governments, and school boards. PSAAB issues such recommendations and guidance to serve the public interest by strengthening accountability in the public sector through developing, recommending and gaining acceptance of accounting, financial reporting and auditing standards of good practice.

These standards are developed by the people who will be governed or affected by them. PSAAB follows a rigorous “due process” that gives those affected by the pronouncements an opportunity to express their views while issues are being considered and recommendations developed. Members of PSAAB and its associates include deputy and assistant deputy ministers, comptrollers, auditors general and executives of government organizations. Two thirds of the members of PSAAB and its task forces who develop the standards are selected from government, made up of those responsible both for financial reporting and for auditing.

Over the years, PSAAB has issued a number of general and specific accounting recommendations that are gaining wide acceptance within Canada, both federally and provincially. A summary of outputs is presented in Exhibit A.1. The result has been much more credible accounting and financial reporting by Canadian governments, and much more support for those who maintain the accounts and those who audit them. This has been particularly important in the past decade as the measurement and reporting of government deficits or surpluses and accumulated debts has taken on considerable significance everywhere.

The Key Role Played in Canada by the Public Accounts Committee of the House of Commons

Since 1979, the PAC has met numerous times to consider the annual financial statements of the Government of Canada and the Auditor General’s related Opinion and Observations. To date, the PAC has issued five reports to the House of Commons on matters relating to the financial statements. A summary of the Committee’s recommendations is presented in Exhibit A.2. Virtually all of these recommendations have now been acted on by the government. This interest and support by the PAC has been a major factor in bringing about strengthened accounting and financial reporting over the years. Significant actions by the government in response to PAC Reports are shown in Exhibit A.3.

Government-wide Financial Reporting across the World

Throughout the 1980s, Canada was virtually alone among industrialized nations in preparing and publishing audited government-wide financial statements at the federal level. However, in 1993, the Government of New Zealand began publishing audited government-wide financial statements. The federal governments of Australia and the United States are planning to follow suit. There are a number of similarities among these three initiatives to implement government-wide financial reporting. For example, in each case:

- the financial statements are or will be prepared in accordance with generally accepted accounting and financial reporting standards, developed objectively by an appropriate standard-setting body;
- the accounting and reporting standards are based on the “accrual accounting” concept in order to help ensure that assets and liabilities are reported completely and valued realistically;

- the exercise of preparing summary financial statements and submitting them for audit is seen as imposing a discipline on individual departments and agencies to strengthen the financial information they use to manage; and
- the financial statements are seen as providing an understandable annual scorecard of where the government stands financially, for use in making strategic decisions and setting overall priorities and policies.

The experience of the Government of Canada in preparing and publishing audited annual financial statements is very similar. We also believe that accountability information about government is needed at two levels: government-wide to determine whether the sum of all program costs is affordable; and program by program to determine which programs are working well and which are not.

Internationally, there has been considerable activity in recent years to develop guidance for governments on financial reporting and accounting. Two organizations — one auditing and the other accounting — are playing a lead role here. Both recognize the importance of governments adopting “accrual accounting” — the type of accounting and financial reporting that PSAAB recommends and that Canadian governments are implementing.

Exhibit A.1

Accounting Guidance from the Public Sector Accounting and Auditing Board

Concepts & Principles

Objectives of Financial Statements — This Section identifies and describes objectives of a government’s financial statements that are generally acceptable to the users and preparers of the statements. These objectives provide the basis for determining standards of financial statement reporting and accounting principles that are consistent with one another and appropriate for government, with the goal of improving government financial statements and enhancing their comparability.

General Standards of Financial Statement Presentation — This Section recommends general reporting principles and standards for the disclosure of information in government financial statements, based on the objectives of government financial statements.

Financial Reporting Entity — This Section defines the scope of the reporting entity in terms of the organizations whose financial affairs and resources should be accounted for in a government’s financial statements and recommends how to account for the financial affairs of those organizations in the government’s financial statements.

Specific items — Financial Reporting

Disclosure of Accounting Policies — This Section deals with the disclosure of accounting policies adopted by a government in the preparation and presentation of its financial statements. Accounting policies are the specific accounting principles used by a reporting entity and the methods for applying those principles.

Accounting Changes — This Section deals with the accounting and reporting in government financial statements of (a) a change in an accounting policy; (b) a change in an accounting estimate; and (c) a correction of an error relating to prior period financial statements.

Subsequent Events — This Section deals with the accounting and reporting in government financial statements of events occurring after the financial statement date that may indicate a need to adjust items or to make specific disclosures in those statements.

Temporary Investments — This Section deals with the accounting and reporting of all investments that are transitional or current in nature in government financial statements.

Specific items — Financial Statement items

Loans Receivable — This Section recommends how to account for and report loans receivable in government financial statements, giving particular attention to special characteristics that distinguish them from commercial loans made in the private sector.

Restricted Assets and Revenues — This Section recommends how to account for and report restricted assets and revenues in the financial statements of governments, which are not available to meet the government’s general obligations and finance its other activities.

Tangible Capital Assets — This Section recommends how to account for and report tangible capital assets in government financial statements, which include such diverse items as roads, buildings, vehicles, equipment, land, water systems, aircraft, computer hardware and software, dams, canals and bridges.

Long-term Debt — This Section deals with the presentation and disclosure of long-term debt in government financial statements.

Employee Pension Obligations — This Section recommends how to account for and report employee pension obligations in government financial statements.

Loan Guarantees — This Section recommends how to account for and report government loan guarantees in government financial

statements. For the purposes of this Section, a loan guarantee is a promise to pay all or a part of the principal and/or interest on a debt obligation in the event of default by the borrower.

Government Transfers — This Section recommends how to account for and report government transfers in the financial statements of governments. For the purposes of this Section, government **transfers** are transfers of money from a government to an individual, an organization or another government for which the government making the transfer does not (a) receive any goods or services directly in return, as would occur in a purchase/sale transaction; (b) expect to be repaid in the future, as would be expected in a loan; or (c) expect a financial return, as would be expected in an investment.

Exhibit A.2

Public Accounts Committee Recommendations Concerning the Financial Statements of the Government of Canada, 1979 through 1997

(Words in italics added)

First Report, 21 February 1979 - Respecting the 1978 Financial Statements

5. Your Committee again recommends that legislative action be taken as soon as possible to delete from the accounts of Canada the assets and liabilities identified in Notes 5 and 7 to the audited financial statements and to prevent similar balances from recurring in future years.
7. Your Committee recommends that the accounting entity of the Government of Canada should include all Crown corporations substantially dependent on public funds or carrying on government operations.
9. Your Committee recommends that the Office of the Comptroller General review each year loans to and equity investments in Crown corporations with a view to recommending that adequate provision be made through budgetary appropriations where such corporations lack sufficient revenues to repay the investment of Canada.
11. Your Committee recommends that:
 - (a) The terms of loans to developing countries and loans to and subscriptions in international development associations be adequately disclosed in the audited financial statements of the Government of Canada; and
 - (b) The Office of the Comptroller General expedite a study to establish an appropriate basis for valuing such loans and subscriptions and report back to the Committee as soon as possible.

Thirteenth Report, 22 March 1982 - Respecting the 1981 Financial Statements

15. Your Committee recommends that:
 - (a) the Comptroller General report back to your Committee on the progress of the studies regarding accounting principles for governments by October 31, 1982 and annually thereafter, until these principles have been established and are in use in the Government of Canada;
 - (b) the Government consider the advisability of amending the Financial Administration Act to vest the responsibility and authority for the improvement of government accounting in the President of the Treasury Board; and
 - (c) the Government consider the advisability of amending the SRBA Act in order to record the actuarial deficiency arising from this Act as a liability in the accounts of Canada. *(This Supplementary Retirement Benefits Act provides for indexing of employee pensions, which was not included in reported liabilities at the time of this hearing)*

Eighth Report, 30 June 1987 - Respecting the 1986 Financial Statements

7. Your Committee recommends that the Government invite the Canadian Institute of Chartered Accountants (CICA) to examine those accounting policies of the Government that cause concern to the Auditor General in his audit of the Government's financial statements or do not fully conform to CICA standards and to recommend changes so that a "clean" Opinion can be obtained. *(Subsequently, the CICA explained that its role was to set standards but not arbitrate)*
15. Your Committee, therefore, recommends that the Government obtain an independent professional opinion from the Canadian Institute of Chartered Accountants on the reporting of sovereign loans where the risk of loss to the Government of Canada is significant. *(See above)*
18. Your Committee recommends that the Office of the Comptroller General provide it with a progress report on the consolidation of Crown corporations in the financial statements of the Government by September 30, 1988.
21. Your Committee recommends that the Office of the Comptroller General provide it with a progress report with respect to the Federal Government Reporting Study recommendations by September 30, 1987. *(The Federal Government Reporting Study was conducted jointly by our Office and the US General Accounting Office; its main recommendation was that the government prepare and publish a concise user-friendly annual financial report)*

Second Report, 10 October 1989 - Respecting the 1988 Financial Statements

14. Your Committee recommends that:
 - (a) the Comptroller General and the Deputy Minister of Finance resolve the issues raised by the reservations of the Auditor General in his

Opinion on the Government's Audited Financial Statements;

- (b) the Minister of Finance introduce accounting policy changes in his 1990 Budget for implementation in the 1989-90 Public Accounts that would permit the Auditor General to remove the reservations in his Opinion on the Government's Audited Financial Statements; and
- (c) the Minister of Finance and the President of the Treasury Board report jointly in writing to your Committee on recommendations (a) and (b) above by March 31, 1990.

Fifth Report, 13 March 1992 - Respecting the 1991 Financial Statements

- A. The Committee recommends: that more accurate estimations of income tax revenue collected on behalf of provinces and territories be used when issuing the next Public Accounts of Canada for 1991-92.
- B. The Committee therefore recommends:
 - (1) that the government correctly account for the actuarial liability associated with wage restraints, by not treating the repercussions of the Public Sector Compensation Act as a curtailment of the federal employees' pension plan. Consequently, the government must amortize this actuarial adjustment over a thirteen-year period, as is generally accepted in sound accounting practice;
 - (2) that, as soon as possible, the government publish corrected financial statements for 1990-91 that perfectly account for the actuarial impact of wage restraints and correctly reflect the repercussions of wage controls spread over two years rather than three. (*The government declined to publish corrected statements*)
- C. The Public Accounts Committee therefore recommends:
 - (1) that the adjustment to the value of the federal government's investment in Petro-Canada be charged off to the 1990-91 fiscal year, the year during which it was identified;
 - (2) that, as soon as possible, the government publish corrected financial statements that faithfully reflect the value of the federal government's investment in Petro-Canada (*see above*);
 - (3) that the government adopt accounting practices that would respect PSAAC (*now called PSAAB*) Accounting Statement 4 (Defining the Government Reporting Entity, November 1988) on accounting for investments in Crown corporations. The government would thus account for Crown corporations' net losses (or gains) as part of its own losses, at the time they occurred.

Exhibit A.3

**Improvements in the Audited Financial Statements of the Government of Canada
1979 through 1994**

1979

Significant "internal accounts" — amounts owed by the government to itself — were removed from the government's statement of assets and liabilities.

1980

Loans to and investments in financially dependent Crown corporations were written down, and additional amounts payable at year-end were recorded in the accounts.

The terms of loans to developing countries and subscriptions to international development associations were disclosed in notes to the statements.

1984

Amounts payable under certain statutory (continuing) authorities were recorded in the accounts, and provision was made in respect of amounts owing for employee vacation and termination benefits.

A liability was included in the statement of assets and liabilities for the government's share of Crown corporation borrowing, and a partial write-down was made for subscriptions to international development associations.

1985

The transactions of the Canadian Ownership Account were included on the statement of revenue and expenditure, instead of being excluded from the deficit as in prior years by being shown on the statement of assets and liabilities.

1986

The separate financial transactions of certain significant departmental activities such as Employment Insurance were consolidated with the government's financial statements.

Loans to developing countries and subscriptions to international development associations were written down in full.

1990

The separate financial statements of financially dependent Crown corporations were consolidated with the government's financial statements.

Loans to other sovereign governments were written down in value.

The liability for employee pensions was recorded fully in the accounts.

The result of all of this was the first "clean" opinion on the annual financial statements.

1993

An allowance for an estimated amount owing under loan guarantees was recorded in the accounts.

A change was made to the way the accounts recognized the effect of wage restraint on the employee pension liability.

1994

A concise, user-friendly annual financial report was published for the first time, containing condensed (simplified) financial statements.

An allowance for loans expected to be recovered from future appropriations was recorded in the accounts.

Appendix B

Recent Correspondence with Government Officials

This chapter calls on the government to follow objective accounting standards in reporting financial results to Parliament and to Canadians. The chapter explains that a significant departure from objective accounting standards has occurred in each of the past two years and could occur again this year. On 12 March 1998, government officials wrote to the Auditor General stating that the government had not departed from these standards and offering arguments to support their view. The Auditor General replied to that letter on 18 March 1998. Both letters were copied to the Chairman of the Public Accounts Committee of the House of Commons and are reproduced on the following pages. In his reply, the Auditor General undertook to provide more detailed comments separately. This has now been done and detailed comments are presented at the end of this appendix. The Auditor General also encouraged continued discussions to resolve the disagreement. Although additional discussions were held with government officials, a resolution was not found.

Treasury Board of Canada
Secretariat

Conseil du Trésor du Canada
Secrétariat

Ottawa, Canada
K1A 0R5

12 March 1998

Mr. L. Denis Desautels, FCA
Auditor General of Canada
240 Sparks Street
Ottawa, Ontario
K1A 0G6

Dear Mr. Desautels:

Last year, with respect to the accounting treatment accorded the transfer payment to the Canada Foundation for Innovation, you included in your opinion on the financial statements of the Government of Canada a reservation that the government was not adhering to its stated accounting policies as described in the notes to those financial statements. The subsequent discussion of this issue at the December 9, 1997, meeting of the Standing Committee on Public Accounts, the announcement by the Minister of Finance in his recent budget of a similar transaction related to the Canada Millennium Scholarship Foundation, and the matters raised in the proposed chapter 9 of your April report make it clear that the government should take action to end this controversy. Therefore, the President of the Treasury Board and the Minister of Finance have agreed to clarify the government's accounting policies to ensure that transactions of the type at issue are accounted for in the fiscal year in which the decision is taken to incur the expenditure.

In its 1997-98 financial statements, the government will revise the note on significant accounting policies to indicate that a public commitment to provide funding to an arm's-length entity represents the establishment of a liability to disburse government funds, and, that in the interests of transparency and accountability, such liabilities are recorded in the financial statements in the year in which the decision to incur such expenditures is made, provided proper parliamentary authority is in place before the financial statements for that year are closed.

Specifically, the government proposes to state in its significant accounting policies (4th paragraph under "Basis of accounting"):

Transfer payments are recorded as expenditures when paid, when the recipient has fulfilled the terms of a contractual transfer agreement, or in the case of non-recurring transactions which do not form part of an existing program, when the government publicly announces a decision to make a transfer, provided enabling legislation or authorization for payment receives parliamentary approval.

In addition, whenever such a non-recurring transaction is recorded, the government will include a separate note to the financial statements describing the transaction and its amount.

The government is of the view that support for recording these transactions can be found in professional literature. For instance, the Handbook of the Canadian Institute of Chartered Accountants (CICA) defines a liability as an obligation arising from past transactions or events, the settlement of which may result in the transfer of assets in the future. The Handbook goes on to note that liabilities do not have to be legally enforceable; they can be based on equitable or constructive obligations. A constructive obligation is a duty based on ethical or moral considerations. A constructive obligation is one that can be inferred from the facts in a particular situation as opposed to a contractually based obligation. It is the government's opinion that the "event" of making a decision to provide funding to a arm's length foundation establishes both a "constructive" and an "equitable" obligation, provided Parliament subsequently provides the necessary authority.

Furthermore, recent changes to CICA Handbook Section 3465, Income Taxes, indicate that it is appropriate to recognize liabilities under the concept of "substantive enactment", i.e. recognizing liabilities if there is persuasive evidence that the government is able and committed to enacting the proposed legislation in the foreseeable future.

A second argument supporting the government's approach is the principle of "substance over form". The CICA Handbook states "transactions and events are accounted for and presented in a manner that conveys their substance rather than necessarily their legal or other form." It is the government's view that reporting the planned transfers to entities such as the foundations reflects the substance of government decision-making and economic reality. To not recognize these obligations on the basis that the "legal work" is not yet in place would be misleading. This same philosophy can be found in the recommendations of the CICA's Emerging Issues Committee to the effect that liabilities related to restructuring costs be recognized when the authoritative decision is made to incur such costs.

This concept also applies to government transfers. CICA Handbook Section PS3410, paragraph .07, states "... Judgement will be required to account for transfers in a manner that best reflects the substance of the underlying events rather than the form or funding pattern."

We would also draw to your attention that the accounting standards require us to consider events occurring between the date of the financial statements and the date of their completion when such events provide sufficient, additional evidence relating to conditions that existed at the date of the financial statements.

We are disappointed that our discussions to date have not been able to resolve this difference of opinion. Your position confuses a legitimate difference of opinion about the appropriate application of accounting standards, thereby, affecting the credibility of the financial statement of the government.

We also wish to register our profound astonishment that this issue has now been reported in the press (Ottawa Citizen, Wed. March 11/98) as a result of an interview you gave. It appears to us that you have taken the unprecedented step of releasing the contents of your report which you fully intend to release in April under the guise of "considering the unusual step of writing a report". We believe this to be inappropriate under the circumstance given your reporting role to Parliament.

We believe that the proposed changes will make it clear to users of the government's financial statements which transactions are included in financial activity for the year and will identify clearly the basis for determining the annual financial results of the government. It is our view that the changes will also lead to better financial reporting to Parliament and the public.

Yours sincerely,

C. Scott Clark
Deputy Minister
Department of Finance

V. Peter Harder
Secretary of Treasury Board/
Comptroller General

c.c.: Mr. John Williams,
Chairman, Standing Committee on Public Accounts

240 Sparks Street
Ottawa, Ontario
K1A 0G6

18 March 1998

Mr. C. Scott Clark
Deputy Minister of Finance
Mr. V. Peter Harder
Secretary of Treasury Board & Comptroller General
Ottawa, Ontario
K1A OR5

Dear Mr. Clark and Mr. Harder:

Thank you for your letter of 12 March wherein you comment on our proposed Chapter 9 that we are considering including in next month's Report to Parliament. I am writing to set out my thoughts on a number of items that you raise in your letter.

You register astonishment that certain of the issues raised in the chapter have been reported in the Ottawa Citizen on 11 March as a result of an interview that I gave. In this respect, I would point out that my deep concern with the government's recent departures from objective accounting standards has been clearly and forcefully reported to Parliament in my Observations on the government's 1996 and 1997 financial statements and discussed in some detail with the Public Accounts Committee during two related public hearings. I have also raised additional concerns with the Innovation Foundation in chapter 36 of last December's Report to Parliament (paragraphs 36.48 to 36.54). With this background in mind, I believe that it was quite appropriate for the media to ask for my views on the accounting proposed for the new Millennium Foundation in last month's Budget and for me to respond in the manner that I did.

In your 12 March letter, you advise that the note on significant accounting policies in the government's 1997-98 financial statements will be revised "... for non-recurring transactions ..." to sweep in as liabilities "... public commitment(s) to provide funding to an arm's-length entity ..." providing "... proper parliamentary authority is in place before the financial statements for that year are closed." You advance a number of arguments to support this change in accounting drawn from the Handbook of the Canadian Institute of Chartered Accountants (CICA). We have studied these arguments and we do not believe that they support the accounting that you propose in your letter. For the most part, your arguments are based on Sections of the CICA Handbook that are unrelated to the central issue of when the Government should recognize transfer payments as liabilities and expenditures. For example, two of the Sections that you refer to deal with (1) how business firms measure income tax liabilities that are already recognized, and (2) when business firms recognize costs of exiting existing activities. In our view, Handbook Section PS3410 provides clear guidance to governments on when transfer payments should be recognized as liabilities and expenditures, and the accounting change that you propose does not conform with this Section. We will communicate more detailed comments to you separately.

Last summer, in a meeting with Mr. Harder and his senior officials, we agreed to work together behind the scenes in order to clarify our interpretation of CICA recommendations as they relate to the accounting for and reporting of

transfer payments. The idea was to head off continuing public disagreement between preparer and auditor with respect to transactions such as the GST/PST harmonization costs and funding of the Innovation Foundation. In early February of this year, Mr. Harder's officials provided my staff with a brief paper outlining considerations and suggestions for resolving these differences. We did not find these considerations and suggestions appropriate for reporting financial results to Parliament and we wrote back promptly to explain why. We note that references to the CICA Handbook in your 12 March letter were not included in this earlier paper.

As Parliament's auditor, I am very concerned with the change to the government's stated accounting policies that you set out in your letter and I strongly urge you not to make it. My concern is two-fold. First, I believe that the change will open the door for governments to influence reported results by simply announcing intentions in their Budgets and then deciding what to include in the deficit or surplus after the end of the year once preliminary numbers are known. Second, I believe that the change represents a significant departure from objective accounting standards recommended in the CICA's Public Sector Accounting and Auditing Board (PSAAB). I refer specifically to Handbook Section PS3410 that recommends standards of accounting and reporting for transfer payments. Canadian governments and their auditors have worked closely with PSAAB over the past two decades to develop public sector accounting standards in an objective and transparent way. I believe that this approach has led to a strengthening of the credibility of reported financial results by Canadian governments. In my view, the unilateral accounting change that you suggest in your 12 March letter will not only weaken credibility of the federal government's reported results, but will send a signal to other governments that the PSAAB process and recommendations need not be followed.

I am quite prepared and would indeed be pleased to discuss this matter further with your Ministers if you think this might help resolve the matter and avoid continued public confrontation between our offices. I would prefer not to include the proposed chapter in next month's Report to Parliament but unless the government's view changes, I do not see that I have much choice. Your comments and suggestions would be appreciated. I would point out, however, that we must advise the Speaker in the next few days of the contents of our April Report; additional discussions would therefore have to occur quite soon.

I look forward to hearing from you.

Yours sincerely,

L. Denis Desautels, FCA
Auditor General of Canada

Copy: Mr. John Williams
Chairman, Standing Committee on Public Accounts

Detailed Comments by the Office of the Auditor General of Canada on the Government's Technical Arguments Contained in Its 12 March 1998 Letter

Introduction and Purpose

On 12 March 1998, the government presented its rationale for the accounting treatment accorded the transfer payments to the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation. The government also described its view of support for this accounting treatment in professional literature. The purpose of this paper is to provide detailed comments on those professional literature references and related commentary.

Recognition of Transfer Payment Liabilities and Expenditures

The central issue on which we disagree is the point in time at which the government should recognize transfer payments as liabilities and expenditures.

It might be helpful to consider liability recognition in the business world as a point of departure for discussing liability recognition in government. Consider a company that decides to acquire a building. At the time of making this decision, the company is not obligated in any way to make a purchase. It may not yet have selected a specific building or made any deal with another party for the purchase. At this point, there would be no disclosure of the decision on the face of the company's financial statements or in related footnotes. When a formal undertaking to acquire a specific building is in place, a "commitment" is made that would be disclosed in the company's financial statements (in the footnotes). A commitment may be thought of as a contractual agreement to incur a liability. Later, when the company takes title to the building, an actual liability is incurred that would be recognized on the face of the company's financial statements (and removed from the footnotes). In commercial accounting, then, liabilities of this nature are recognized only when suppliers carry out their side of the deal to obligate the purchaser.

The situation in government is not as straightforward. Governments often make what are called "transfer payments" – payments for which no goods or services are received directly by government from the recipients of the payments. Transitional assistance for GST/PST harmonization, funding of the Canada Foundation for Innovation and funding of the Canada Millennium Scholarship Foundation are examples of transfer payments. Because transfer payments are quite different from anything seen in the business world, the Canadian Institute of Chartered Accountants (CICA) Public Sector Accounting and Auditing Board (PSAAB) has developed and published recommended standards that deal specifically with when governments should recognize transfer payments as liabilities and expenditures. This specific Section of the CICA Public Sector Accounting and Auditing Handbook – PS 3410 – is discussed more fully below. One key criterion set out in this Section is that recipients of transfer payments must meet eligibility criteria in order for governments to recognize transfer payments as liabilities and expenditures. This key criterion may be thought of as a surrogate for "suppliers carrying out their side of the deal" – the recognition event that we have in the business world as explained in the preceding paragraph.

In its 12 March 1998 letter, the government states that it is of the view that support for recording transactions such as funding of the Canada Foundation for Innovation and the Canada Millennium Scholarship Foundation can be found in professional literature. The government provides specific references to CICA Handbook Section 1000, *Financial Statement Concepts*, CICA Handbook Section 3465, *Income Taxes* and the CICA's Emerging Issues Committee (EIC) Abstract # 60, *Liability Recognition for Costs Incurred to Exit an Activity (including certain costs incurred in a restructuring)*. Before commenting on each of these references, this paper discusses briefly the application to government of recommendations issued by PSAAB. (Throughout this paper, PSAAB recommendations in the CICA Public Sector Accounting and Auditing Handbook are prefixed with the letters "PS". Recommendations for profit-oriented enterprises are prefixed by the words "CICA Handbook Section".)

The Introduction to PSAAB recommendations states that accounting recommendations apply to all governments unless individual Sections specifically limit their application. PSAAB Accounting Recommendations include PS 3410 on government transfers referred to above. As there are no limitations on its applicability to the federal government, this is the Section that should be used in deciding when transfer payments should be recognized as liabilities and expenditures. The government's current stated accounting policy for transfer payments complies with PS 3410.

As explained earlier in this paper, PS 3410 was developed by PSAAB to address specifically the question of when governments should recognize transfer payments as liabilities and expenditures. Recognition criteria are set out in paragraph 07. This paragraph also states, "Judgment will be required to account for transfers in a manner that best reflects the substance of the underlying events rather than the form or funding pattern." In the case of the payments to the Innovation Foundation and the Millennium Foundation, both of which are grants, it should not be necessary to rely on this "judgment" clause of paragraph 07 because paragraph 38 provides quite precise guidance for recognizing liabilities for grants. Paragraph 38 states, "Liabilities should be recognized by the transferring government for any unpaid, authorized grants at the end of the accounting period for which the recipients have met eligibility criteria, if any, prior to the end of that period." Accordingly, for the Innovation Foundation to have been included in last year's financial statements, it would have had to be in existence and a funding agreement in place by 31 March 1997. Since neither of these conditions was met, we concluded that including \$800 million in liabilities and expenditures last year contravened both objective accounting standards recommended by PSAAB and the government's own stated accounting policies.

CICA Handbook Section 1000 – Financial Statement Concepts

When a specific standard such as PS 3410 exists, it takes precedence over more general guidance such as financial statement concepts. The purpose and scope of CICA Handbook Section 1000 state that it is to be used in exercising professional judgment on the application of generally accepted accounting principles and in areas where accounting principles are developing. CICA Handbook Section 1000 is not to be used to override any accounting principle that is considered to be generally accepted, such as PS 3410 on government transfers. We believe that in PS 3410, PSAAB sets out the criteria to be used to implement the CICA Handbook Section 1000 general liability definition in the specific context of government transfers. Accordingly, the basic principles used to define a liability have already been considered by PSAAB when PS 3410 was developed. We therefore do not believe that it is necessary to look outside PS 3410 for additional guidance on the issue of when the government should recognize transfer payments as liabilities and expenditures. Nevertheless, this paper comments on the other specific Sections of the CICA Handbook that are raised in the government's 12 March 1998 letter.

CICA Handbook Section 3465 – Income Taxes

The reference provided in the 12 March 1998 letter relates to how business firms estimate future income tax liabilities that are already recognized. The concept of “substantive enactment” is only used in the “measurement” part of CICA Handbook Section 3465, and addresses specifically the income tax rate that the firm should use in estimating its income tax liability. Because CICA Handbook Section 3465 deals with *measurement* of income tax liabilities that already exist as opposed to *recognition* of liabilities that do not yet exist, we do not believe that it applies, even indirectly, to the determination of when the government should recognize transfer payments as liabilities and expenditures.

EIC-60 – Liability Recognition for Costs Incurred to Exit an Activity (Including Costs Incurred in a Restructuring)

In its 12 March 1998 letter, the government argues that EIC-60 supports its position to record certain transfer payments as liabilities and expenditures when the decision is made to incur them. In fact, EIC-60 was created to *limit* the costs that business firms could recognize, based solely on management decisions in a year, to those that relate to exiting an existing activity. Specific criteria are provided in EIC-60 that effectively prevent firms from artificially inflating operating results of future years by inappropriately loading costs from those years into the current year. For exit costs to be recognized, they must relate to activities being carried on *prior* to what is called the “commitment date” or to a contractual obligation that existed *prior* to the commitment date. EIC-60 specifically prohibits recognizing a liability at the commitment date for costs that relate to activities that will be continued. Given this background, we do not believe that EIC-60 applies to the determination of when the government should recognize transfer payments as liabilities and expenditures.

Subsequent Events

We agree that objective accounting standards require that events occurring between the date of the financial statements and the date of their completion be considered in finalizing the numbers each year. However, additional information available after the fiscal year end is normally used to confirm or strengthen the valuation or estimate — the *measurement* — of an asset or liability that already exists at year end. Subsequent events are normally not used in deciding what assets or liabilities should be *recognized* at year end. Information in the subsequent period may also be used to provide evidence as to the *probability* of an event having actually occurred as at the fiscal year end. However, this is not relevant to the current discussions because it is a fact that an agreement with provinces to harmonize GST and PST was not in place at 31 March 1996 and we know that the Innovation Foundation did not legally exist at 31 March 1997. Put simply, if a transaction does not meet the definition of a liability as at the end of a fiscal year, no amount of “subsequent events” would change this. For the transactions on which we disagree, there is no “past event” creating a liability at year end; a management decision is not enough.

We have, in prior years, looked to subsequent events to provide evidence for the *authorization* of transfer payments. In cases such as the elimination of the Crow subsidy, eligibility criteria had been met by recipients that existed as at year end and a reasonable estimate of cost could be made as at year end. Government officials proposed, and we agreed, that in situations such as this the enactment of legislation in the subsequent period could be considered in determining whether proper authorization was in place.

Conclusion

In summary, we have studied the arguments contained in the 12 March 1998 letter and we do not believe that they support the accounting proposed by the government. In our view, PS 3410 provides clear guidance to governments on when transfer payments should be recognized as liabilities and expenditures, and the accounting change proposed by the government does not conform to the recommendations in that Section.

**Office of the Auditor General
24 March 1998**

September 1998

Foreword and Main Points

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Report of the Auditor General to the House of Commons for September 1998

Foreword

I am pleased to present the September volume of my 1998 Report. Bound with this Foreword are the Main Points of nine chapters, which are issued separately:

10. Canadian Human Rights Commission - Human Rights Tribunal Panel
11. Agriculture and Agri-Food Canada - Cash Advance Program
12. Creation of the Canadian Food Inspection Agency
13. National Energy Board
14. Indian and Northern Affairs Canada - Comprehensive Land Claims
15. Promoting Integrity in Revenue Canada
16. Management of the Social Insurance Number
17. Patented Medicine Prices Review Board
18. The Financial Information Strategy: A Key Ingredient in Getting Government Right

With this Report, I continue to develop several of the issues raised in my 1997 Matters of Special Importance: moving the focus from inputs and process toward results; maintaining accountability as activities move outside of traditional government structures; promoting integrity within government; and making comptrollership a reality.

Shifting the focus toward results is fundamental to increasing the effectiveness of day-to-day government operations. In an environment where the nature of organizations is changing and programs face competing objectives, it is essential that managers set specific goals for program performance, measure and report on progress, and use that information to ensure that the government can meet its objectives. Effectiveness tools such as evaluations have a key role to play by providing decision makers with information on how well policies and programs are working and how they can be improved.

Another matter I raise in this Report is the government's shift from traditional ways to new methods of delivering some services and programs to Canadians. Some of the changes allow for greater flexibility in managing resources, particularly human resources. However, accountability for the results is still essential. This will require a common understanding of roles and responsibilities, clearly stated objectives and expectations, and full and frank reporting on performance. The challenge will be to incorporate flexibility and accountability together without reverting to traditional ways of doing business.

Laying a strong ethical foundation for the promotion of integrity within government is another issue I examine in this Report. The government needs to promote a framework that focuses on principles, leadership, empowerment of public servants to act in the public interest, training, and mechanisms for reporting concerns. There is still a need to be vigilant in promoting ethical conduct in government.

Last, I look at improvements the government is making in its financial management capabilities, and the structure it is creating to allow decision makers to assess the financial consequences of their decisions.

Success in all of these areas depends on the visible commitment of management at the highest levels. Managers will need to marshal support throughout the organization, following best practices and lessons learned from the experience of others and integrating them into day-to-day decision making.

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Canadian Human Rights Commission

Human Rights Tribunal Panel

Chapter 10 - Main Points

10.1 In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve human rights complaints quickly, impartially and expertly. The Commission investigates complaints and, if it decides that an inquiry is warranted, forwards the complaint to the Tribunal for adjudication. This model was chosen as the alternative to the formal processes of the courts. However, the approach that has evolved is cumbersome, time-consuming and expensive.

10.2 Between 1988 and 1997, the Commission received about 7,450 signed complaints, excluding pay equity complaints. It made final decisions on about 6,550 of the 7,450 signed complaints. The Commission dismissed or did not proceed with about two thirds of these complaints. About six percent of complaints were forwarded to the Tribunal for inquiry.

10.3 Although major efforts have been made to improve the handling of complaints, it still takes a long time for a complaint to be reviewed — an average of about two years for the Commission and about a year for the Tribunal. In 1997 almost one half of the Commission's 900 open cases were still being investigated one year after the signing of the complaint.

10.4 The Commission tries to settle complaints through conciliation and the Tribunal also tries to mediate complaints after the Commission forwards them for inquiry. Because the Commission has its own settlement objectives, it is not a neutral conciliator. Since 1996 about 18 percent of complaints have been settled through early resolution or conciliation. The Commission took an average of about 45 months to reach a final decision when complaints were investigated and then sent to conciliation.

10.5 The Commission and the Tribunal are operating in a complex environment that poses major risks. The grounds for making a complaint are increasing and concepts of discrimination are becoming more complex. The environment also is more litigious and contentious. The Commission's total funding has been reduced from a high of \$16.15 million in 1992-93 to \$14.8 million in 1998-99. The number of investigators also has been reduced from a high of 37 to 25. Further, the Commission is experiencing a high turnover of investigative staff, necessitating the reassignment of cases to other investigators. We also are concerned that the Commission is not consistently adhering to some of its key investigative standards.

10.6 We note that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has welcomed this proposal. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment.

10.7 We agree that a fundamental review by Parliament is needed and recommend that the government identify and present to Parliament an integrated set of specific measures to increase the effectiveness of addressing human rights complaints. Possible measures are summarized in the concluding section of this chapter.

Agriculture and Agri-Food Canada

Cash Advance Program

Chapter 11 - Main Points

11.1 The Department's cash advance program is one vehicle the government makes available to producers of storable crops to provide additional flexibility in making marketing decisions. It consists of a short-term loan made available at harvest, a time when financial obligations of producers are often at their peak. The financing provides a bridge for producers until they market their crop and begin to earn revenue. In recent years, the annual amount of these loans has ranged from \$730 million to over \$1.2 billion.

11.2 The program has been very well received. Producers we contacted liked the availability and predictability of cash flow at harvest time, and the interest-free feature of the program. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

11.3 In 1993, the Department's Review Branch completed an evaluation that reached some positive conclusions about the program, but also raised some significant concerns, particularly with the program's interest-free nature. It also concluded that there was no firm evidence that the program contributes to orderly marketing.

11.4 In 1997 new legislation, the *Agricultural Marketing Programs Act (AMPA)*, was passed that updated and consolidated the two previous cash advance programs into one, and made permanent in legislation the interest-free provision. The rationale for providing advances interest-free was not made clear by the government, despite the evaluation's finding that a clear objective for this component was needed.

11.5 Under the new legislation, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness; however, as in any study, some questions remain unanswered that we believe should be addressed in the coming review. Among others, these include whether producers indeed face a significant problem of access to credit at harvest time and whether losses arising from the government's guarantee on these loans are being well managed.

11.6 We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are indeed taking steps in this direction.

Creation of the Canadian Food Inspection Agency

Chapter 12 - Main Points

12.1 The federal government is considering the use of alternative service delivery (ASD) arrangements in order to improve service delivery. The Canadian Food Inspection Agency (CFIA) was the government's first legislated service agency; it was created as a departmental corporation and became operational 1 April 1997. Its primary responsibility is to contribute to food safety, plant and animal health as well as to facilitate trade in all areas by providing inspection and related services.

12.2 There was a clear rationale for creating the Agency, including a 30-year history of studies related to reorganizing the federal food inspection system and the government's commitment to a new and better way of delivering services. Senior officials of the three federal departments then involved in food safety inspection supported the initiative to create a single food inspection service. This initiative illustrated that change can be best introduced and sustained when there is a clear rationale that has the support of senior officials.

12.3 The designation of a structured and independent team was crucial to managing the move to agency status. The team's work was separate from the ongoing business of inspections and quarantine activities, so those services could continue without interruption throughout the creation of the CFIA.

12.4 One of the driving forces behind the move to ASD arrangements is their greater flexibility in human resource management. With the move outside the *Public Service Employment Act* and the change to separate employer status, the shift to a new human resources regime was one of the Agency's greatest challenges. The complexities entailed in creating a new human resource framework as a separate employer need to be recognized and planned for early in the change process.

12.5 In an area of shared responsibility such as food safety, roles need to be carefully defined and mechanisms established to resolve unanticipated problems. The establishment of an accountability framework was a key concern during the creation of the CFIA. Specific responsibilities for food safety were assigned to the Minister of Agriculture and the Minister of Health. Some operational details were still being worked out as new issues arose during the first year of operations.

National Energy Board

Chapter 13 - Main Points

13.1 The *National Energy Board Act* has not been amended significantly since it established the National Energy Board (NEB) in 1959. While the NEB has been given some new responsibilities in areas such as frontier activities, its role has not changed much since its creation. However, its modus operandi has changed significantly. Through regulatory changes, the Board has moved from an interventionist approach to reliance on market-based forces, industry self-regulation and negotiated toll structures. During this period of evolution, the NEB has moved its operations from Ottawa to Calgary, downsized its staff complement by 35 percent and reorganized itself internally for greater efficiency. However, it has not objectively measured the extent to which it is being effective and relevant.

13.2 The Board has recognized that the aging of the Canadian pipeline system poses potential threats to public safety and the environment. The number of reported pipeline incidents has increased in recent years. A risk assessment methodology is being developed that should improve the targeting of inspections and safety audits. However, deficiencies in information management will need to be addressed.

13.3 The Board's ability to fully meet its environmental regulatory responsibilities is at risk due to shortfalls in its environmental inspection program — namely, in setting priorities and scheduling inspections and in inspection practices, which are too informal and unstructured.

13.4 Since 1991, the NEB has recovered most of its costs from industry. No change has yet been made to its cost allocation method, despite some concerns expressed by stakeholders about its fairness. The NEB has settled for simplicity at the expense of cost causality. The Board does not have a cost accounting system; it needs to recover costs in a way that is more equitable and acceptable to stakeholders.

13.5 The NEB is moving toward management for results, by adopting a new accountability framework and changing its style of decision making. While it is too early to evaluate the results of this initiative, we noted that significant opportunities exist to better link its human resource management activities to its vision of the future. In addition, the NEB will need to state and report clearly what it wants to achieve, monitor its performance on a regular and systematic basis and better link the results achieved to the costs.

Indian and Northern Affairs Canada

Comprehensive Land Claims

Chapter 14 - Main Points

14.1 Comprehensive land claim settlements are modern treaties that are significant not only to Aboriginal communities but also to all Canadians. Settlements involve the payment by the federal government to Aboriginal groups of almost two billion dollars and the clarification of various rights, including full ownership of over a half-million square kilometres of land. The first modern negotiated settlement of a comprehensive land claim was signed in 1975, and the most recent settlement was reached in July 1997. As of July 1997, 12 claims had been settled. Actual and potential claims involving over 200 First Nations are still to be settled.

14.2 The Government of Canada has chosen to settle these claims by negotiation rather than litigation or other means. Indian and Northern Affairs Canada is the lead federal representative in negotiations, with participation of other federal departments as appropriate. Other parties include the territorial governments, provincial governments, and the claimants. Although the Department bears significant accountability for results, it is not the only party that should be accountable; the good will and political resolve of all participants are needed in order to achieve appropriate settlements.

14.3 The government has reported that negotiated settlements establish certainty to land title and access to land and resources. However, removing uncertainty involves much more than signing an agreement. Among other things, successful implementation of settlements is critical to achieving the intent of these treaties. Implementation involves hundreds of projects with joint or separate participation of the parties. We found deficiencies in implementation, including inadequate or non-existent implementation plans, and the need to improve monitoring, reporting and evaluating.

14.4 Indian and Northern Affairs Canada has not demonstrated that it has always exercised adequate rigour in determining the nature and amount of assets that may ultimately be included in final settlements, including such considerations as the amounts of cash, land and other resources.

14.5 Settlements can take over 20 years to reach. Delays have had many causes. In our view, these long time frames do not contribute to cost effectiveness, and may result in less desirable outcomes for all concerned.

Promoting Integrity in Revenue Canada

Chapter 15 - Main Points

15.1 The success of Revenue Canada's programs depends largely upon voluntary compliance with tax requirements by individuals and businesses. We believe that one of the many factors affecting the likelihood of their voluntary compliance is their perception of the conduct of Revenue Canada's staff. An organization like Revenue Canada, with its decentralized operations and the extensive exercise of judgment by employees, must take adequate precautions to minimize the risk of employee misconduct. Our audit looked at various means that the Department employs to promote integrity among its employees.

15.2 All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. The Department investigates incidents of misconduct; discipline is imposed on employees found guilty of misconduct; and, on the whole, management takes appropriate action, where weaknesses are highlighted by incidents, to prevent similar misconduct. Further, distributing statements of its mission, vision and values and three key booklets on conduct are important steps Revenue Canada has taken toward promoting an ethical culture. Most employees have received some formal training on expected conduct.

15.3 There are areas where improvement will help Revenue Canada reinforce this sound foundation. Because the disciplinary process can be slow, its effectiveness as a deterrent to similar misconduct may be diminished. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than department-wide weaknesses. Further, information provided on values and conduct is not presented in a way that allows easy understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of expected values and conduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

Management of the Social Insurance Number

Chapter 16 - Main Points

16.1 The Social Insurance Number (SIN) was implemented in 1964, to provide Unemployment Insurance, Canada Pension Plan and Quebec Pension Plan clients with a file number. In 1967, it also became a file identifier for Revenue Canada. From the outset, the SIN was the subject of intense parliamentary interest and debate. The controversy focussed largely on the implications of a potential expansion of its use to become a universal identifier. The history of the SIN has mainly reflected the tension between balancing the often competing objectives of maintaining individual privacy and improving administrative efficiency and effectiveness.

16.2 Human Resources Development Canada has been administering the SIN in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs. However, the public often perceives the SIN to be a personal identifier or even an identity card.

16.3 The use of the SIN outside the federal domain has evolved beyond the intent of the Treasury Board policy established in 1989, aimed at preventing it from becoming a national personal identifier. Our audit found that the SIN has become the common numerical identifier both inside and outside the federal government for a wide range of income-related transactions and benefits, among other uses.

16.4 Changes to the *Income Tax Act* and Regulations have increased the use of the SIN at the provincial/territorial level and in the private sector, as have the growing number of data exchanges, comparisons and matches among various tiers of social programs.

16.5 However, the SIN has a number of weaknesses. Some of them are well known. As the use of the SIN has become more widespread, these weaknesses have grown in importance. They include the following:

- The information on SIN holders, particularly on births and deaths, is not always complete and accurate.
- Existing SIN application procedures are insufficient to guard against fraud and abuse. Holders of 11.8 million SINs who registered prior to the introduction of the proof-of-identity program in 1976 have not been asked to provide proof-of-identity documentation. This exacerbates the risk of misrepresentation.
- The provinces and financial institutions are required by the *Income Tax Act* and Regulations to collect SINs for tax purposes but cannot validate the SIN numbers provided by their clients.
- SIN errors, abuse, and misuse affect many federal programs, provinces and the private sector. Collectively, the impact may be sizable.
- Minimal effort is dedicated to investigations of SIN fraud and abuse, and penalties are minimal, with no real impact on deterrence.
- Unregulated use in the private sector, except in Quebec, makes it vulnerable to abuse in terms of both privacy and fraud.

16.6 The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

16.7 There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized. In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness, and finding a satisfactory solution.

Patented Medicine Prices Review Board

Chapter 17 - Main Points

17.1 The Patented Medicine Prices Review Board (PMPRB) is a small quasi-judicial board with an annual budget of approximately \$3 million and 35 full-time-equivalent employees. Created in 1987, it has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive. However, the scope of its jurisdiction and the limitations of its consumer protection role are not widely understood.

17.2 Since 1988, average annual increases in prices of patented medicines have moderated. The Board has contributed to the containment of patented drug prices, and has taken steps to assess the impact of federal price regulation. However, other factors also have contributed and we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated. In reporting its results to Parliament, the Board did not clearly identify the limitations of the estimates of its own impact.

17.3 The audit identified issues pertaining to the legislative framework that need to be reviewed. The legislation is silent or unclear on certain areas. In addition, some requirements under the legislation are difficult to apply in practice, and consideration needs to be given to reviewing their continued relevance.

17.4 The majority of patented drugs sold in Canada are priced within the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Improvements are also required in the reporting of drug price trends and pharmaceutical research and development expenditures.

The Financial Information Strategy: A Key Ingredient in Getting Government Right

Chapter 18 - Main Points

18.1 Under the Financial Information Strategy (FIS), the government is making sweeping changes in the type of financial information provided to decision makers. FIS involves the move to full accrual accounting similar to that used by business firms, the implementation of new financial systems and the integration of full accrual financial information into day-to-day decision making of departmental managers. When fully implemented, by 2001 according to the current plan, FIS should help the government strengthen significantly its management of business lines and its accountability to Parliament. The government has clearly indicated that it is committed to *getting government right* and has established FIS as one important initiative in doing this. The Office of the Auditor General fully supports the stated objectives of FIS.

18.2 FIS began a decade ago. Progress in the early years was slow, but in recent years the tempo of work has picked up. To date, FIS has focussed on implementing new departmental financial systems that are Year 2000-compliant and on ensuring that departmental and central systems will provide appropriate information to include in the government's annual financial statements.

18.3 However, the government has yet to implement its plans to deal with the important area of making full accrual financial information available to officials within departments and agencies who manage business lines and related components on a day-to-day basis. One of the objectives of FIS is to provide officials with more complete information on costs to compare with results achieved when making key decisions. Until this is done, the full benefits of FIS will not be realized.

18.4 While better cost information for decision making is a benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of FIS implementation, which could be significant.

18.5 The government and Parliament can help ensure the success of FIS by appropriating funds on a full accrual basis, so that accountability and reporting are on the same basis. But central agencies and individual departments must also act to help ensure that the full benefits of FIS are achieved. Central agencies must secure complete departmental "buy-in", and deputy ministers of individual departments must put in place the necessary infrastructure, including appropriate systems and human resources.

18.6 Departments face a major challenge in completing the renewal of their financial systems to meet the objectives of FIS. Best practices and lessons learned from others who have gone before can help achieve success.

18.7 Given the massive scale of financial systems renewal now under way to meet the Year 2000 challenge, we believe that there is a unique opportunity to put FIS in place by the 2001 target implementation date. This is not a simple task. To obtain the full benefits of FIS and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to track the government's progress in implementing FIS and achieving these benefits.

Chapter 10

Canadian Human Rights Commission

Human Rights Tribunal Panel

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Canadian Human Rights Commission

Human Rights Tribunal Panel

Main Points

10.1 In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve human rights complaints quickly, impartially and expertly. The Commission investigates complaints and, if it decides that an inquiry is warranted, forwards the complaint to the Tribunal for adjudication. This model was chosen as the alternative to the formal processes of the courts. However, the approach that has evolved is cumbersome, time-consuming and expensive.

10.2 Between 1988 and 1997, the Commission received about 7,450 signed complaints, excluding pay equity complaints. It made final decisions on about 6,550 of the 7,450 signed complaints. The Commission dismissed or did not proceed with about two thirds of these complaints. About six percent of complaints were forwarded to the Tribunal for inquiry.

10.3 Although major efforts have been made to improve the handling of complaints, it still takes a long time for a complaint to be reviewed — an average of about two years for the Commission and about a year for the Tribunal. In 1997 almost one half of the Commission's 900 open cases were still being investigated one year after the signing of the complaint.

10.4 The Commission tries to settle complaints through conciliation and the Tribunal also tries to mediate complaints after the Commission forwards them for inquiry. Because the Commission has its own settlement objectives, it is not a neutral conciliator. Since 1996 about 18 percent of complaints have been settled through early resolution or conciliation. The Commission took an average of about 45 months to reach a final decision when complaints were investigated and then sent to conciliation.

10.5 The Commission and the Tribunal are operating in a complex environment that poses major risks. The grounds for making a complaint are increasing and concepts of discrimination are becoming more complex. The environment also is more litigious and contentious. The Commission's total funding has been reduced from a high of \$16.15 million in 1992-93 to \$14.8 million in 1998-99. The number of investigators also has been reduced from a high of 37 to 25. Further, the Commission is experiencing a high turnover of investigative staff, necessitating the reassignment of cases to other investigators. We also are concerned that the Commission is not consistently adhering to some of its key investigative standards.

10.6 We note that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has welcomed this proposal. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment.

10.7 We agree that a fundamental review by Parliament is needed and recommend that the government identify and present to Parliament an integrated set of specific measures to increase the effectiveness of addressing human rights complaints. Possible measures are summarized in the concluding section of this chapter.

Introduction

Role of the Canadian Human Rights Commission

10.8 The *Canadian Human Rights Act* sets out the Commission's responsibilities. The purposes of the Act are to protect individuals from discrimination and promote equality of opportunity. It applies to federal government departments and agencies, Crown corporations, chartered banks, airlines, telecommunications and broadcasting organizations, and shipping and interprovincial trucking companies.

10.9 The Commission investigates complaints of discrimination. Complaints may relate to employment, or to the provision of goods, services, facilities and accommodation that are customarily available to the general public. The Commission also has a statutory responsibility to foster public understanding and recognition of the principles of the Act.

10.10 Complaints of discrimination may be made based on race, national and ethnic origin, colour, religion, age, sex, sexual orientation, marital status, family status, disability or conviction for an offence for which a pardon has been granted. Complaints of discrimination based on sex include complaints about pay inequities between men and women.

10.11 In October 1996, amendments to the *Employment Equity Act* came into force. The purpose of the Act "is to achieve equality in the workplace so that no person shall be denied employment opportunities or benefits for reasons unrelated to ability." The Commission is responsible for the enforcement of the obligations imposed on employers by the Act.

10.12 The Commission currently consists of the Chief Commissioner and six part-time members appointed by the Governor in Council. It has about 180 full-time equivalent employees. During 1997-98, the Commission spent about \$15 million and plans to spend about \$14.8 million in 1998-99.

Role of the Human Rights Tribunal Panel

10.13 If the Commission decides, based on its investigation, that an inquiry is warranted, it refers the case to the Tribunal. The Commission then represents the public interest before the Tribunal. The Tribunal, as a quasi-judicial body, holds hearings to decide whether there has been a discriminatory practice prohibited by the *Canadian Human Rights Act*.

10.14 During 1997-98, the Tribunal consisted of the President and about 40 Governor-in-Council-appointed active panel members. It has a staff of 14 public servants. The Tribunal's 1997-98 budget was about \$1.9 million and is expected to be about \$2.2 million in 1998-99.

Focus of the Audit

10.15 The primary focus of our audit was to examine whether:

- the existing accountability and independence frameworks ensure independence from government while still retaining appropriate accountability;

- the process for handling human rights complaints is accessible, equitable and well managed within available resources; and
- the Commission is in a position to implement its new employment equity audit mandate under the *Employment Equity Act* in a satisfactory manner.

10.16 We reviewed the timeliness of addressing pay equity complaints. However, we did not review in detail the management and investigation procedures for such complaints because they differ significantly from other complaints and would require a separate audit. We also did not examine the Commission’s human rights promotion program because our audit of its complaints management process required more time and resources than anticipated.

10.17 We reviewed the Tribunal’s financial and management controls and its mediation process; however, we did not review Tribunal hearing procedures.

10.18 We interviewed a wide cross section of stakeholders. The Commission and the Tribunal assisted by identifying the stakeholders they believed we should interview to obtain reliable information on the mandate and operations of both entities. Further details on our audit objective, scope and approach are found at the end of the chapter in the section **About the Audit**.

Observations

Canadian Human Rights Commission

The grounds for complaints about discrimination are expanding

10.19 The *Canadian Human Rights Act* contains a list of specified prohibited grounds of discrimination. The grounds have evolved as a result of court decisions and amendments to the Act, which are sometimes subsequent to court decisions. The Commission tries to expand the interpretation of the Act through court cases, sometimes in collaboration with complainants’ counsel.

10.20 Requests for revisions come from members of Parliament, the Commission itself and “equality seeking groups” representing, for example, women, same sex couples, individuals with disabilities, low income individuals and different racial and ethnic communities. Exhibit 10.1 summarizes the type of requests that have been made.

Exhibit 10.1

Requests for Revisions to the *Canadian Human Rights Act*

Requests for revisions to the *Canadian Human Rights Act* include:

- the prohibition of mandatory retirement;
- the prohibition of discrimination on the grounds of source of income or social condition, political belief and criminal conviction or charge;
- the removal of restrictions on the Commission’s authority to deal with human rights questions concerning native peoples;
- the removal of the requirement that the victim of a discriminatory practice be “lawfully present” in Canada; and
- the establishment of enforceable standards for accessibility to facilities.

10.21 The Commission also advocates changes to the Act. For example, the Commission has decided it can address larger social issues, such as poverty, that may go beyond its immediate jurisdiction. The Commission told us “this is consistent with the overall purpose of the Act which is to guarantee equality of opportunity.” Its 1997 Annual Report to Parliament recommended that social condition be included as a prohibited ground of discrimination.

10.22 Since the Act was passed, four amendments have been made to the prohibited grounds of discrimination. Two grounds — family status and sexual orientation — were added, and the ground of disability was expanded. A fourth amendment, clarifying an organization’s duty to accommodate individuals with special needs unless it causes undue hardship for the organization, was included in Bill S-5 promulgated in May 1998. The amendment follows a Supreme Court ruling as well as a series of rulings by other courts. The Bill also requires the Commission to accept and investigate complaints of retaliation against a complainant and it provides for the filing of a complaint based on multiple grounds.

10.23 The Federal Court is currently reviewing the constitutionality of the provision in the *Canadian Human Rights Act* that permits mandatory retirement where the retirement age is fixed by law or regulation.

Decisions are made independently of government

10.24 The Commission is an investigative and decision-making body and the Tribunal is a quasi-judicial body that, like the judiciary, makes findings of fact and adjudicative decisions. These entities are expected to operate and be seen to operate independently of the government of the day.

10.25 Organizational independence. Government departments and the Treasury Board often are the subject of investigations and employment equity audits by the Commission and are respondents in hearings before the Tribunal. At the same time, the Treasury Board approves the budget of both agencies and both are subject to all Board regulations and policies. The Minister of Justice is responsible for the *Canadian Human Rights Act* and for the Commission and the Tribunal. As Attorney General of Canada, the Minister often represents departments in the negotiation of settlements of cases with the Commission and before the Tribunal and the courts.

10.26 In certain instances, the perception of the independence of the Commission and the Tribunal from the government is strained. These instances involve major cases where the government, as the employer, is the respondent before the Tribunal and where additional major funding is required for lengthy hearings. In such instances, the Treasury Board is both the approver of requests for such funds and the respondent to the case being heard.

10.27 We did not find evidence that the government is using funding controls to hamper the Commission or the Tribunal in the fulfilment of their responsibilities. In practice, we found that additional funds usually have been provided to the Commission and the Tribunal when needed. However, there is an absence of legislative safeguards.

10.28 There are also concerns about the independence of the Tribunal from the Commission. Recently, the Federal Court found that the Tribunal was not independent of the Commission. Certain provisions of Bill S-5 are intended to address this issue.

10.29 Independence of appointees. Appointees to the Commission and Tribunal should be and be seen to be independent and qualified. The Governor in Council appoints full- and part-time members to the Commission and the Tribunal. Bill S-5 addresses some of the issues relating to the independence of appointees to the Tribunal; for example, it establishes qualifications for appointment to the Tribunal and extends the terms of the Chairperson for up to seven years and of Tribunal members for up to five years.

10.30 Bill S-5 also specifies procedures for removal of members of the Tribunal. The procedures are similar to those proposed for other administrative tribunals in Bill C-44, which received first reading in June 1998.

10.31 Other safeguards for Commission and Tribunal appointments that would help ensure the personal independence and quality of appointees include:

- increasing transparency in the appointment process by having stated criteria for qualifications and by widely advertising openings for both full- and part-time appointments;
- having a panel of experts and eminent citizens or a legislative committee interview and recommend candidates for appointment by the Governor in Council; and
- setting the salary and benefits of appointees by statute — perhaps by fixing them in proportion to the statutory remuneration of federally appointed judges.

10.32 Conflict of interest. Like other full- and part-time Governor in Council appointees, members of the Commission and Tribunal are subject to the principles in Part I of the government's Conflict of Interest and Post-Employment Code for Public Office Holders. Both the Commission and the Tribunal require all members to certify that they are complying with the principles.

10.33 The Ethics Counsellor informed us that he would be writing to all part-time Governor in Council appointees to ensure that they fully understand that they are subject to the principles of the Code.

10.34 Part II of the Code, which requires disclosure of assets and outside activities to the Ethics Counsellor, does not apply to part-time Governor in Council appointees. The Tribunal, however, requires its part-time appointees to make such a disclosure to its President or Registrar. As well, it requires compliance with its own principles for maintaining independence, impartiality, confidentiality and proper conduct.

10.35 Independence of reporting. The ability to report to Parliament independently of government control is essential to the effectiveness of the Commission and the Tribunal. Bill S-5 provides for the Commission and the Tribunal to submit their annual reports directly to Parliament rather than through the Minister of Justice.

Major delays still exist in processing human rights complaints

10.36 The Commission is required by legislation to deal with almost all of the complaints it receives and the Tribunal is required to deal with all complaints referred to it by the Commission. The responsibilities conferred have increased as a result of the expansion of the prohibited grounds of discrimination by courts and Parliament.

10.37 Between 1988 and 1997, the average annual number of signed complaints was about 745, excluding about 175 pay equity complaints filed during this period. The Commission consolidated similar pay equity complaints and thus the total number of pay equity complaints was larger.

10.38 To be effective, the Commission must investigate complaints quickly, impartially and expertly. In 1985 we reported that the major operational challenge faced by the Commission was to reduce the long delays in its investigation of complaints and to reduce the backlog of complaints to a reasonable level.

10.39 The Commission has established new standards for the resolution of an "average" complaint. In 1985 the Commission's general standard was six months to process a case. Its current standard, reconfirmed by the Commission in 1990, is nine months from the date a complaint is signed to its presentation to Commissioners for decision. If Commissioners send a complaint to conciliation, then four to six months are added to this standard.

10.40 Between January 1988 and November 1997, Commissioners reached final decisions on about 6,550 cases, excluding pay equity cases. On average, the Commission took about 27 months to reach these decisions, including 25 months to dismiss cases and 23 months to decide that there would be no further proceedings. Our calculations exclude the time between the deferral of a decision, where a “lead case” was before the Tribunal or the courts or was being investigated, and the reinitiation of consideration of such cases.

10.41 The Commission implemented a new seven-phase system in February 1994 to expedite investigations. To take into account that a new system may not initially operate at full efficiency, we measured the time the Commission has taken to reach final decisions since January 1996. On average, the Commission took about 23 months to reach about 1,170 final decisions. It took three or more years to reach a decision on about 16 percent of cases.

10.42 We also assessed the extent to which the Commission met the time standards it established in 1994 for phases of the complaint management process. We measured the time taken to complete key steps for cases filed between January 1996 and November 1997. Exhibit 10.2 shows that the average time to complete key steps exceeded the Commission’s standards. For example, the Commission’s time standard to complete an initial investigation was about 5.5 months after a complaint was signed. In practice, the Commission took an average of about 10 months to complete initial investigations. In about 26 percent of cases, it took over one year.

Exhibit 10.2

Comparison of Average Time Taken to Complete Investigation Phases With Commission Standards

Phase	Standard (Days)	Average Actual Time (Days) 1996-1997¹
Phase 1 Intake and early resolution Signing of complaint	30	72
Phase 2² Assigning investigator Screening of complaint	7	34
Phase 3 To notify respondent To receive respondent reply To request complainant rebuttal To receive complainant rebuttal To disclose investigation report to parties To receive replies from parties To submit documentation to Commissioners	40 17 40 37 15 7	60 30 45 110 N/A N/A
Completion of Phases 2 and 3	163	287
Phase 4 In-depth investigation	90	172
Phase 5 Commissioners’ decision	N/A	58
Phase 6 Conciliation	120 to 180	208
Phase 7		

Hearing at Tribunal	N/A	N/A
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¹Average actual time the Commission took to complete an activity on complaints signed from 1 January 1996 to 17 November 1997.

²The seven-day standard covers Phase 2 activities and the letter of notification of the parties in Phase 3.

N/A = Not available.

10.43 Most of the delay under the control of the Commission occurs in the disclosure of the investigation report to the parties. The Commission’s time standard for this step is about a month. However, between January 1996 and November 1997, it took an average of about 3.7 months to complete this step; in about 23 percent of the cases, it took more than 5 months.

10.44 Significant delays also result from the Commission not having the legal authority to enforce deadlines. For example, the Commission requests that respondents reply to a complaint within 40 days of notification. The average reply, however, takes 60 days, with about 15 percent of respondents taking 90 days or more to reply. In such instances, the Commission’s only recourse is to send additional reminders to provide the information.

10.45 If a case is sent to Tribunal or appealed to the Federal Court, it could take several years from the day a complaint is signed with the Commission for a case to be resolved. Some stakeholders suggested that the parties be allowed to take their cases directly to the Tribunal or the Federal Court for a hearing on the merits of their case. This could decrease the time and cost of resolving complaints, particularly when complainants and respondents have significant resources and expertise.

10.46 The role of the Tribunal would need to be reconsidered if complaints were brought directly to the Court. To protect the public interest, the Commission could have a statutory right to be an intervener in all cases.

10.47 Pay equity complaints. Reliable data on the time it takes to process pay equity complaints are available for complaints filed since January 1993. Commissioners have reached decisions on 13 of the 36 pay equity complaints filed since this date, taking an average of about 1.5 years. About one half of the complaints have either been dismissed or not pursued by the Commission. On average, the remaining 23 complaints have been on file with the Commission for over three years.

10.48 Large pay equity complaints may take years to resolve because the proof required to sustain an allegation is complex and court challenges are frequent.

The Commission is encountering problems eliminating its backlog

10.49 The Commission considers a complaint to be in its “backlog” if it is still actively being investigated nine months after being signed. In 1997 the Commission had about 900 open cases, of which about 48 percent were in its backlog. About the same percentage of cases were still being investigated one year after they had been signed. Exhibit 10.3 provides an overview of the Commission’s workload during 1991 to 1997.

Exhibit 10.3 is not available, see the Report.

10.50 In 1989-90, the Commission received a permanent annual funding increase of about \$411,000 for nine full-time additional investigators to eliminate its backlog over a five-year period. In addition, to reduce its backlog, the Commission spent almost \$1 million between 1992-93 and 1997-98 to hire contractors to conduct investigations. This amount included additional one-time funding of \$400,000 from the Treasury Board in 1992-93.

10.51 Between 1991 and 1995, the backlog ranged from about 62 to 72 percent of the Commission’s open cases. There are differences of opinion on why the backlog was not reduced as planned. The Commission’s December

1991 submission to the Treasury Board included a request for an additional \$1.82 million over four years to reduce its backlog. The submission noted that the initial funding has been based on an underestimate of the number of new signed complaints that it would receive.

10.52 The Treasury Board declined to provide further resources beyond the 1992-93 one-time spending authority of \$400,000, because resources it had previously provided to the Commission for investigations were being used to encourage complaint volume and for other discretionary activities. The Commission was informed that further resources would not be provided until it demonstrated that it had assigned priority to investigations and conciliations by reallocating existing resources to restore its capacity in these areas.

10.53 The Commission is considering requesting additional one-time funding of \$1 million to reduce its backlog of cases over a two-year period.

Most complaints are not proceeded with or are dismissed

10.54 Exhibit 10.4 summarizes decisions by Commissioners. Commissioners have dismissed or decided not to proceed with almost two thirds of signed complaints.

Exhibit 10.4 is not available, see the Report.

10.55 A dismissal decision results when Commissioners decide there is a lack of evidence to support the allegation. Most of the time, the Commission does not proceed with a complaint because the complaint has been resolved by the parties, the complainant wants to discontinue action or has not responded to requests for information, or the respondent is no longer available. However, the Commission did not record explanations for over one third of the cases where a decision was made not to proceed.

The investigation environment is complex and poses major risks

10.56 Investigations are taking place in a difficult environment. The prohibited grounds of discrimination are increasing and are becoming more complicated. The environment also is more litigious and contentious. The courts have required the Commission to disclose more information to the parties and recommended that the Commission provide reasons for its decisions. As described earlier, the Commission also is experiencing problems completing its investigations in a timely manner and eliminating its backlog of cases.

10.57 The roles of the Commission to promote and advocate human rights and to impartially investigate complaints also add to the complexity of the environment. This duality of roles requires that the Commission balance its advocacy role with the need to investigate or conciliate complaints in a manner that is timely and that maintains the credibility of its impartiality.

10.58 Stakeholders have many concerns about various aspects of the Commission's operations. These include:

- a potential conflict of interest among the different roles of the Commission — advocating social policies, helping to draft complaints, investigating complaints, conciliating complaints, representing the public interest before the Tribunal and the courts, and sometimes collaborating with complainants' counsel to expand the interpretation of the *Canadian Human Rights Act*;
- the Commission's investigations being too cursory and cases being dismissed without full investigation;
- the delays in processing cases undermining the fairness of the process;

- the Commissioners, without giving clear reasons, dismissing complaints or not pursuing them when conciliation fails; and
- the Commissioners not providing sufficient information on the reasons for their decisions.

10.59 Like other government entities, the Commission's funding has been reduced. The Commission's total funding was reduced from a high of about \$16.15 million in 1992-93 to \$14.8 million in 1998-99. The 1998-99 funding level includes about \$800,000 to conduct employment equity audits. In response to funding reductions, the Commission downsized its regional offices, centralized its investigation function in Ottawa, and reduced the number of investigators from 37 to 25.

10.60 Since downsizing its regional offices and centralizing investigations, the Commission has experienced a high turnover of its investigation staff. Because staff from the regions did not accept transfers to the National Capital Region, the Commission had to hire 14 new investigators. Since 1995, 15 investigators have left the unit that handles most complaints, six within a year of being hired. As a result, a series of investigators often work on the same case. The Commission told us it takes about a year for an investigator to become fully functional. Currently, 14 of the 22 investigators in this unit have less than a year's experience.

10.61 The Commission rarely uses its authority to initiate complaints because it has been challenged in the courts and lengthy litigation has ensued. One of the major grounds for challenges is that there is an "apprehension of bias" because the Chief Commissioner approves the initiation of the complaint and then presides over a meeting of Commissioners to decide whether the complaint is valid. As a result, the Commission told us that "in situations where the Commission is interested in pursuing an issue, it has found that there are usually third parties who are willing to file a complaint."

10.62 The Commission's work is subject to judicial review by the Federal Court. To date, the Court has generally upheld the Commission's decisions, although it has sometimes expressed significant concerns about how the Commission has managed complaints. Recent decisions of the Federal Court that found a lack of sufficient independence of the Tribunal from the Commission and errors in law relating to pay equity by the Commission may result in more challenges to its jurisdiction and impartiality.

Clear investigative standards are needed to manage the risks

10.63 We believe that it is essential that the Commission's investigations be rigorous because of the difficult operating environment and because the investigations form the basis for decisions involving fundamental human rights.

10.64 The *Canadian Human Rights Act* provided for the passage of regulations establishing procedures to be followed by investigators. However, the Commission has chosen to establish administrative standards rather than regulations.

10.65 The Commission's standards are contained in its Compliance Manual and Training Manual. The Compliance Manual states that the "manual includes procedures, directives and technical descriptions intended to ensure that compliance activities are performed in a fair, consistent and timely manner by Commission staff."

10.66 We requested that the Commission provide us with its most up-to-date compliance and training manuals and keep us informed of any changes to them. The Commission provided us with its 1994 Compliance Manual and 1995 Training Manual. Based on this information, we concluded that the Commission's investigation standards were generally satisfactory. However, we could not conclude that numerous directives on investigation procedures issued since January 1994 had been integrated into the manuals, or codified in any way. The Commission also could not confirm that it had provided us with the total number of directives issued on these matters.

10.67 Subsequent to finalization of our audit report, the Commission informed us that it had almost completed revising its Compliance Manual. We plan to review the investigation standards in the revised Manual in our follow-up audit.

10.68 We assessed the Commission's investigation procedures to determine whether the Commission was adhering to its own standards. This involved reviewing the Commission's investigation files that it identified as representative of its standard of good investigations. We selected a random sample of 50 complaint files for further review.

10.69 The relevant information for the investigation of a complaint is supposed to be contained in four key documents: the Complaint Analysis and Assignment Form, the Investigation Plan, the Complaint Analysis Report and the Investigation Report.

10.70 Based on their own and their supervisor's judgment, investigators depart from Commission standards. We found that the Complaint Analysis Report and the Investigation Report are completed as required. However, the documents that precede these reports — the Complaint Analysis and Assignment Form and the Investigation Plan — often are not completed. These two documents are supposed to contain information identifying the type of discrimination involved, the objectives of the investigation, the type of evidence required to substantiate whether the form of discrimination has occurred, and the sources of evidence.

10.71 The Commission told us that the information required by these documents could be found in the letter of notification to the respondent and in the Investigation Report. However, we could not conclude that the key information could be found in these documents.

10.72 We also found that the results of key discussions between investigators and supervisors as well as of telephone discussions and interviews with the parties often are not recorded in the files. As well, the chronology of the processing of the complaint submitted to Commissioners with investigation reports does not have sufficient information to allow them to understand the reasons for delays or their impact on the investigation process.

10.73 The Commission told us that our findings focussed on procedural matters rather than the quality of investigations. We explained, however, that to comment on the quality of investigations would require that we verify the accuracy of the investigations conducted by the Commission. This would be costly, time-consuming and impractical. Thus, we focussed on the Commission's adherence to its key investigative standards that it established to ensure that quality is built into investigations from the start.

10.74 We are concerned that the Commission is not consistently adhering to some of its key investigation standards that are designed to ensure the quality of investigations. Since it is investigating allegations of violations of fundamental rights, the Commission needs clear standards that should be followed for the conduct of investigations.

10.75 The Commission needs to have clear and required investigation standards that would allow the Commission and others to ensure accountability and transparency in the investigation and decision process. In addition, clear standards are needed for the disclosure of information to complainants and respondents during investigations and on decisions. Such standards also would help increase the confidence of stakeholders in the Commission. Further, they would help the Commission manage risks arising from a complex and litigious environment where investigations may last on average two years and where there is a high turnover in staff, requiring the Commission to rely on inexperienced investigators.

10.76 We also believe it is important that the Commission conduct periodic audits of its investigations. The Commission's plans to conduct such audits in 1995-96 were not implemented.

The conciliation process needs to be improved

10.77 The settlement of a complaint involves the parties reaching a mutually satisfactory agreement. The Commission tries to settle complaints through conciliation prior to the signing of a complaint, during investigation and after investigation. The Tribunal also tries to settle complaints through mediation after the Commission forwards them for an inquiry. Stakeholders believe that the Commission should try to settle complaints as early as possible. A complainant can withdraw the complaint at any time and settle privately with the respondent.

10.78 We estimate that since 1996 about 18 percent of cases have been settled through some form of conciliation — 11 percent through early resolution before or during investigation, with or without the assistance of the Commission. The 7 percent sent to conciliation after investigation were, on average, before the Commission for about 45 months before a final decision was made. The conciliation phase alone took an average of about 11 months to complete. About 60 percent of the cases sent to conciliation after investigation were settled.

10.79 Commission conciliators are usually drawn from the ranks of investigators. On average, conciliators receive about six days of conciliation-related training over several years.

10.80 The Commission wears several hats in the conciliation process: it facilitates a settlement between the parties, it provides information on precedents, it protects the public interest and it approves the settlement.

10.81 The Commission is not a neutral third party in the conciliation process. Conciliators formulate objectives for the settlement based on the investigation file and their knowledge of Commission policies and Tribunal precedents. They then prepare a conciliation plan for approval by their supervisors, outlining the maximum conciliation objectives. The plan is prepared and approved without talking to the parties and conciliators do not necessarily disclose to the parties that they have their own conciliation objectives.

10.82 Complainants are generally contacted by telephone to find out what settlement would be acceptable to them. Subsequently, the settlement request is presented to respondents. The actual person against whom the allegation of discrimination has been made is rarely involved in the conciliation process. The “respondent” contacted is usually a professional representative of the organization employing the person against whom the complaint was made. Complainants usually represent themselves.

10.83 We believe that the Canadian Human Rights Commission’s conciliation efforts would be improved by using mediation upon receipt of a complaint. We note that the Ontario Human Rights Commission has reported that it recently initiated a voluntary mediation program to resolve cases in the early stages of complaint processing. The Ontario Commission acts as a neutral third party with a strict separation between its mediation and investigation functions. However, it reserves the right to reject settlements that it does not believe are in the public interest. Its mediators receive extensive training before conducting mediations. During the first year of operation of the program, the Ontario Commission reported that 60 percent of the parties have opted for mediation, resulting in an 81 percent settlement rate within 91 days of the filing of a complaint.

10.84 The establishment by the Commission of a similar mediation program could result in complaints being resolved sooner and with less cost. As explained earlier, allowing parties to take their cases directly to the Tribunal or Federal Court could also have the same result, particularly when the parties have significant resources and expertise. Together these measures could allow the Commission to refocus its investigative resources.

Employment equity compliance audit plans are satisfactory

10.85 The purpose of the *Employment Equity Act* is “to achieve equality in the workplace.” The Act applies to about 410 entities, including government departments and agencies, Crown corporations, and private sector companies. These entities are subject to compliance audits by the Commission. Among the private sector companies

are chartered banks, airlines, trucking companies and broadcasting and telecommunications organizations. The 410 entities employ about 860,000 persons. The Commission is responsible for the enforcement of certain obligations required of employers by the Act. Exhibit 10.5 summarizes these obligations.

Exhibit 10.5

Summary of Obligations of Employers Under the *Employment Equity Act*

Obligations of employers under the *Employment Equity Act* include the following:

- Eliminate employment barriers and institute positive employment equity policies.
- Collect information to determine the under-representation of designated groups in each occupational group in the work force.
- Prepare and implement employment equity plans.
- Inform employees about employment equity plans.
- Consult and collaborate with employee representatives to implement employment equity.
- Maintain records on the implementation of employment equity.

10.86 The Act empowers the Commission to conduct compliance audits. It also requires that the Commission, wherever possible, resolve cases of non-compliance “through persuasion and the negotiation of written undertakings.” However, as a last resort, the Commission may issue a “direction” requiring the employer to take specified actions to remedy non-compliance.

10.87 While the amendments to the *Employment Equity Act* came into force in October 1996, employers were given one year to comply with the Act prior to audits being conducted. In January 1997, the Commission established an Employment Equity Branch to conduct compliance audits. In 1996-97, the Commission spent about \$1.2 million to prepare for compliance auditing and conducted voluntary audits to test audit procedures. The Commission’s plans call for the expenditure of about \$6 million on employment equity activities from 1997-98 to 1999-2000.

10.88 The Commission plans to audit all 410 entities over a five-year cycle starting in October 1997. It expects that audits will take between 30 and 60 days, depending on the size of the entity’s work force. It also expects that the time needed to conduct the first audits will be reduced because most employers will have only begun to respond to the requirements of the *Employment Equity Act*.

Employment equity audits are complex

10.89 The Commission’s audit criteria include 12 major categories encompassing 40 criteria. In practice, the audits require that employers establish plans to ensure that designated groups are fairly represented in their work force. Exhibit 10.6 describes the designated groups.

Exhibit 10.6

Employment Equity Designated Groups

The employment equity designated groups are:

- Women
- Aboriginal peoples
 - Indians

- Inuit
- Metis
- Persons with disabilities with long-term or recurring physical, mental, sensory, psychiatric or learning impairments:
 - who believe themselves, as a result of the impairment, to be disadvantaged; and
 - who believe that, as a result of the impairment, an employer is likely to consider them to be disadvantaged.
- Members of visible minorities, other than Aboriginal peoples, who are non-Caucasian in race or non-white in colour.

10.90 Employers are required to determine whether under-representation exists by comparing the representation of designated groups in their organizations against their “work force availability”. The Commission uses the term “work force availability” to describe the number of persons in a designated group in the general or regional population that have the appropriate qualifications. Employers also are required to make several comparisons for each designated group where under-representation has been found. Exhibit 10.7 summarizes the Commission’s employment equity audit criteria, including the comparisons that employers must make.

Exhibit 10.7

Summary of Commission Audit Criteria for the Assessment of Organizations

- Organizations should have :
- plans to ensure that designated groups are fairly represented in their work force;
 - assessments of their work force to determine the degree of under-representation of designated group members in each occupational group;
 - comparisons for each designated group where under-representation has been found, including the:
 - shares of hiring of under-represented groups’ members with external representation of groups in the general or regional population;
 - shares of promotions group members have received with internal representation in the organization;
 - termination rates of the group members with the termination rates for non-designated group employees in the organization;
 - employment policies and practices that do not contribute to under-representation of designated group members.

10.91 Employers will have to use reliable estimates of representation of designated groups in the appropriate population, and employees will have to co-operate by voluntarily self-identifying as a member of a designated group. Without this information, inaccurate employment equity hiring targets and practices may result. Also, without a sound analysis of employment policies, certain employment practices may be initiated without a good understanding of the source of the problem of under-representation.

Performance reporting on complaints management needs to be improved

10.92 While bodies such as the Commission and Tribunal need to be independent of government, appropriate accountability procedures for the expenditure of public funds are necessary. Parliament needs information that provides assurance that the members of such bodies are working diligently, within their mandate, and that the agencies are operating efficiently and effectively.

10.93 The Commission currently provides to Parliament an Annual Report and an annual fall departmental Performance Report.

10.94 The information the Commission provides on its management of complaints of discrimination could be significantly improved. The Commission provides only summary information on the number of complaints filed and their disposition. It could improve its performance reporting by providing information on the delivery of services against defined standards.

10.95 The Commission also could establish objectives and numerical targets for its operations and for improvements. For example, it could set goals for the number of new complaints that should be resolved in a fiscal year, establish deadlines for eliminating its backlog, and set targets for the number of complaints that could be settled by early resolution within a specific period of time. This information could be reported for the previous and current fiscal years and for a five-year average. Similar goals and performance measures could be developed for pay equity complaints and promotion activities.

10.96 Useful information on employment equity is contained in the Commission's 1997 Annual Report. Charts are provided comparing the representation of the four designated groups by departments and agencies of government and the private sector. Crown corporations are included with private sector companies. The report also describes the most common problems encountered by organizations in complying with the *Employment Equity Act*. However, information on the cost and progress of audits could be added.

Cost effectiveness of new information technology needs to be better assessed

10.97 Since 1992, the Commission has spent approximately \$3 million to implement new information technology systems. The Commission employs four full-time equivalent analysts to maintain the systems. It spends about \$750,000 annually — about five percent of total expenditures — to support its information systems. The Commission's spending on information systems is similar to that of public sector organizations of the same size with similar activities.

10.98 We focussed on the Commission's complaints management system because it is one of the main management instruments for the Commission's key functions — the investigation and conciliation of human rights complaints. Since 1992, there have been two major development projects costing about \$900,000. A third iteration has just begun and the Commission plans to spend up to \$300,000 over the next two years to replace the system.

10.99 Despite these major investments, management believes that much of the information derived from the system is unreliable. Consequently, it supplements the information by other measures intended to validate the information in the system or to replace it. However, we verified the accuracy of the information in the system and used it to assess the key aspects of the timeliness of complaint processing. The Commission's system was not designed to readily produce this information.

10.100 The Commission has recently completed a user need analysis and has prepared data and criteria to be used to evaluate alternatives for its new system. We are concerned that the Commission has not clearly defined key objectives and operational benchmarks for the new system that would allow it to assess gains in efficiency and effectiveness from this investment. The gains could be measured in terms of productivity improvements, reduction in task time, and reduction in delays prevented by accurate and timely reporting on case management.

Clear authority and improved management controls for contribution agreements are needed

10.101 Our major concern is about authority and management controls for international projects that the Commission undertakes on behalf of the Canadian International Development Agency (CIDA).

10.102 CIDA funds the projects under a document called an “Agreement” signed by CIDA and the Commission. To date, the total value of the agreements is about \$2.6 million over a four-year period. The Commission spends about \$60,000 annually administering the agreements.

10.103 After obtaining funds from CIDA, the Commission enters into contribution agreements with non-governmental organizations and provincial human rights commissions to carry out the projects outlined in the Agreements between CIDA and the Commission. Agreements have been signed to support human rights commissions in two countries.

10.104 We are concerned about a lack of clear authority for the Commission to enter into these types of agreements with CIDA. We also could not identify a clear authority for the Commission to sign contribution agreements with third parties. Further, the Treasury Board must approve the terms and conditions of contribution agreements unless the Board has delegated such authority. We found that the Commission did not obtain the needed approval, nor had the Board delegated the authority.

10.105 The Commission’s financial controls for its contribution agreements are generally satisfactory; however, its management controls need improvement. The Commission cannot readily assure CIDA that it is managing and coordinating the projects, ensuring effective control of project resources and ensuring that procurement of materiel is in accordance with established Canadian government procedures.

10.106 The Commission agrees that the management of its international projects has presented difficulties. It “now recognizes that it must take a more hands-on approach,” and has recently taken steps to improve its management of the contribution agreements. These measures include making on-site visits, requiring status reports, and documenting decisions.

Human Rights Tribunal Panel

Financial controls are generally satisfactory

10.107 The Tribunal’s largest expenditure is on professional and special services, including remuneration to Panel members and contracts for translation services and temporary office support. In 1997-98, the Tribunal spent about \$1 million for such services. We found the financial controls for these expenditures to be generally satisfactory.

The Tribunal process is lengthy

10.108 Like the Commission, the Tribunal was established to resolve allegations of discrimination quickly and expertly. As indicated, between 1988 and 1997, Commissioners reached final decisions on 6,550 complaints. They decided to refer about six percent of these complaints to the Tribunal. During the period 1996 to 1997, 33 cases were sent to the Tribunal.

10.109 The steps in the processing of a complaint at the Tribunal include a pre-hearing meeting, mediation, if all parties agree, and the hearing of the complaint if mediation fails. A one- or three-member panel can hear a case. Until recently, when a one-member Tribunal’s decision was appealed, a three-member Review Tribunal was set up to review the decision. Since 1979, there have been 47 review tribunals. The provision for review tribunals was removed by Bill S-5. Parties may challenge a decision by requesting the Federal Court to conduct a judicial review. Sometimes the Commission asks for judicial reviews of decisions of tribunals.

10.110 Since 1996, the Tribunal has taken an average of about a year to complete hearings and render decisions on cases that are not settled through mediation. Decisions are rendered on average about five months from the last day

of the hearing. Pay equity cases may take more than 100 days of hearing and cost more than \$700,000. This cost does not include the costs incurred by the parties.

10.111 Since January 1996, 19 Federal Court decisions on Tribunal findings have been reported, with 11 decisions holding against the Tribunal. The most common finding was that Tribunals made errors in law.

10.112 Overall, stakeholders believe the Tribunal's approach to conducting hearings is cumbersome. They expressed concerns about the length of hearings, in part due to the inefficient hearing procedures and the need for part-time members to juggle their schedules.

10.113 As indicated, legislation recently approved by Parliament resolved some of these concerns. Bill S-5 specifies the qualifications for new panel members, and lengthens the terms of the Chairperson and Vice-Chairperson from five to up to seven years. It also may reduce scheduling problems by providing for the appointment of full-time members.

The Tribunal's approach to mediation is generally satisfactory

10.114 The Tribunal started to mediate complaints sent to it by the Commission in 1996. The parties voluntarily choose mediation and the Tribunal mediator is impartial. There may be several different parties in a case. About 56 percent of parties opt for mediation at the time of the pre-hearing conference. It takes about two months to complete the mediation effort, with a settlement rate of about 70 percent.

10.115 However, the Tribunal does not have the statutory authority to mediate complaints. It also does not have formal standards and policies governing mediation and the mediators rely on their own experience.

Performance reporting needs to be improved

10.116 The Tribunal's fall 1997 Performance Report to Parliament stated that its objective is to provide Canadians with "a fair, impartial and efficient public inquiry process for the enforcement and application of the *Canadian Human Rights Act* and the *Employment Equity Act*." The report provides useful information on the Tribunal's average cost per case by both ground and year, on the average number of hearing days per case by ground and by year, on the number of cases resolved through Alternative Dispute Resolution and on the outcomes of cases.

10.117 The Tribunal's Performance Report states that it will achieve its objective by demonstrating, for example:

- timeliness of the hearing and decision process;
- increased use of Alternative Dispute Resolution processes; and
- well-reasoned decisions, consistent with the evidence and the law.

10.118 We believe that establishing targets such as reducing the average costs and hearing days by a specified percentage could enhance reporting.

10.119 We noted that the report does not contain information on the elapsed time between hearing a case and rendering a decision. We found that it takes on average about a year for tribunals to complete hearings and render a decision on complaints referred to it by the Commission. However, more complex cases can take much longer.

Conclusion and Recommendation

10.120 In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve complaints about human rights quickly, impartially and expertly. This model was chosen as the alternative to the formal legal processes of the Federal Court. However, the approach that has evolved is cumbersome, time-consuming and expensive.

10.121 The Commission and the Tribunal are operating in an increasingly litigious and complex environment that poses major risks. In general, while stakeholders appreciate that the Commission and the Tribunal are dealing with difficult matters, they have major concerns about the efficacy of the process.

10.122 The Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has stated that this should be done sooner rather than later. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment. We agree that a fundamental review by Parliament is needed. The various issues we have identified are for the most part interrelated and cannot be easily addressed individually.

10.123 The government should identify and present to Parliament an integrated set of specific measures to improve the effectiveness of addressing human rights complaints. Such measures could:

- provide for periodic reviews by Parliament of the relevance and impact of the grounds of discrimination;
- broaden the choice of ways that complainants and respondents could use to resolve human rights complaints, possibly permitting complainants to take cases directly to the Tribunal or the Federal Court;
- clearly separate the Commission's roles as promoter of human rights, investigator and conciliator of complaints, representative of the public interest and advocate for an expanded interpretation of the *Canadian Human Rights Act*;
- ensure that the Commission and the Tribunal are independent and accountable;
- provide for greater transparency in appointments to the Commission and Tribunal;
- establish statutory deadlines for the receipt and disclosure of information to and by the Commission;
- ensure that specific standards are established and followed that safeguard the reliability, impartiality and transparency of the investigation, conciliation and decision-making processes;
- require clear, complete and timely disclosure of reasons for decisions;
- require parties to consider voluntary mediation by a neutral independent mediator, early in the complaint management process;
- ensure that there is legislative authority for the mediation policies and procedures that may be used by the Commission and Tribunal;
- require greater disclosure of information on performance against defined service standards; and

- **ensure that there are legislative authority and resources to undertake international projects.**

Canadian Human Rights Commission's response: In general, the Commission finds the report's observations helpful, and has already begun to address some of the major recommendations.

With respect to the complaints process, the Commission recognizes that the time taken to deal with complaints is unsatisfactory. This is a problem faced by all human rights commissions, and one that for the Canadian Human Rights Commission has been exacerbated by past budgetary reductions and difficulties arising from the current law. We anticipate that the general review of the Canadian Human Rights Act announced by the Minister of Justice will provide the opportunity to consider alternatives to the current approach. In the meantime, we will continue to seek ways to speed up the process, including making greater use of mediation. It is also the Commission's intention to seek one-time funding from the Treasury Board to reduce the current backlog of complaints.

In terms of the quality of investigations, we continue to believe that complaints are properly investigated and that the Commissioners are provided with the information they require to make informed decisions. Some of the standards noted in the report were put in place at a time when the Commission's workload was less demanding, and their contribution to the investigation process may need to be reassessed.

As the report points out, providing assistance to human rights institutions in other countries is a new area of activity, which has increased significantly over the past few years. The Commission intends to seek confirmation of its mandate in this area, and to ensure that the resources and systems required to meet the demand effectively are in place.

As a final point, we should note that the audit does not examine the Commission's promotion activities. These are an important element in the Commission's statutory mandate.

Human Rights Tribunal Panel's response: We are in general agreement with the conclusions and recommendations contained therein that pertain to the Tribunal Panel.

About the Audit

Objective

The objective of the audit was to determine whether:

- the activities of the Canadian Human Rights Commission and the Human Rights Tribunal Panel are consistent with their mandates under the *Canadian Human Rights Act* and *Employment Equity Act*;
- appropriate accountability and independence frameworks are in place to ensure independence from government with appropriate complementary accountability, including whether results are usefully measured and reported to management and Parliament;
- the process for handling human rights complaints is accessible, equitable and well managed within available resources;
- the Commission is in a position to implement its new employment equity audit mandate under the *Employment Equity Act* in a satisfactory manner;
- information technology planning is adequate; and
- financial risks are well managed.

Scope and Approach

We interviewed Commission and Tribunal officials. We discussed mandate, accountability and independence issues, and the operations of the Commission and Tribunal with a wide cross section of stakeholders. We asked the Commission and the Tribunal to help identify the stakeholders we should interview to obtain reliable information on the mandate and operations of both entities. We interviewed these stakeholders as well as others to whom these parties referred us. We also examined reviews of provincial human rights commissions and obtained information for comparison purposes from provincial and other national human rights commissions and ombudsmen.

We reviewed the information provided by the Commission and the Tribunal to Parliament in their Estimates, annual reports and performance reports. We also reviewed decisions of the Federal Court and the Supreme Court on the Commission and the Tribunal. In addition, we examined relevant studies conducted by the Commission and the Tribunal.

We verified and used the data in the Commission's complaint management system to describe the nature and disposition of complaints received by the Commission and the timeliness of dealing with complaints. Manuals and policy documents of the Commission and the Tribunal were reviewed and a stratified random sample of 50 investigation complaint files and a random sample of 20 conciliation files were examined.

We examined the Commission's audit plans for implementing its new employment equity mandate. We compared the Commission information technology planning practices with those recommended by the Treasury Board and those used by comparable agencies.

We examined financial and management controls relating to pay and benefits, contracts and contribution agreements.

Criteria

In assessing the Canadian Human Rights Commission and the Human Rights Tribunal Panel, we used as audit criteria management standards and policies, Treasury Board policies, and practices in and studies on comparable commissions and tribunals.

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Chapter 11

Agriculture and Agri–Food Canada

Cash Advance Program

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Agriculture and Agri–Food Canada

Cash Advance Program

Main Points

11.1 The Department's cash advance program is one vehicle the government makes available to producers of storable crops to provide additional flexibility in making marketing decisions. It consists of a short-term loan made available at harvest, a time when financial obligations of producers are often at their peak. The financing provides a bridge for producers until they market their crop and begin to earn revenue. In recent years, the annual amount of these loans has ranged from \$730 million to over \$1.2 billion.

11.2 The program has been very well received. Producers we contacted liked the availability and predictability of cash flow at harvest time, and the interest-free feature of the program. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

11.3 In 1993, the Department's Review Branch completed an evaluation that reached some positive conclusions about the program, but also raised some significant concerns, particularly with the program's interest-free nature. It also concluded that there was no firm evidence that the program contributes to orderly marketing.

11.4 In 1997 new legislation, the *Agricultural Marketing Programs Act (AMPA)*, was passed that updated and consolidated the two previous cash advance programs into one, and made permanent in legislation the interest-free provision. The rationale for providing advances interest-free was not made clear by the government, despite the evaluation's finding that a clear objective for this component was needed.

11.5 Under the new legislation, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness; however, as in any study, some questions remain unanswered that we believe should be addressed in the coming review. Among others, these include whether producers indeed face a significant problem of access to credit at harvest time and whether losses arising from the government's guarantee on these loans are being well managed.

11.6 We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are indeed taking steps in this direction.

Introduction

11.7 Managing cash flow is an ongoing challenge for all businesses, including agricultural producers. They incur significant up-front costs with no guarantee that a saleable product will result, and they face difficult decisions about when to sell their product in order to maximize overall returns. These decisions involve weighing a multitude of factors, including expected pricing patterns, borrowing capacity and costs, the likelihood of delivery opportunities, transportation to destination, on-farm storage capacity and others. As one farmer remarked to us during our work, “Why would I want to visit a casino? Farming is itself enough of a gamble.”

11.8 The cash advance program of Agriculture and Agri-Food Canada is one tool the government makes available to producers of storable crops to provide additional flexibility in making these marketing decisions.

How cash advances operate

11.9 Producers apply for cash advances through their respective producer organizations after the crop is harvested. For many producers, this is the time of year when financial obligations are at their peak. Cash advances are basically short-term loans. The harvested crop serves as the collateral for the cash advance. Typically, producers may obtain an advance for up to 50 percent of the expected selling price of their crop.

11.10 The federal government pays the interest on the first \$50,000 of an advance. The maximum advance is \$250,000 but, in practice, few producers take advances beyond \$50,000. For example, with respect to cash advances for prairie grain producers, only about 1,300 of the 26,700 advances made in 1997-98 were for amounts exceeding \$50,000.

11.11 Exhibit 11.1 describes the situation of a typical Prince Edward Island potato farmer during the crop year.

Exhibit 11.1 is not available, see the Report.

11.12 Producer organizations negotiate the loans for the cash advances through local banks or other financial institutions. The largest of the producer organizations — the Canadian Wheat Board — is empowered to raise financing on its own. Because repayment of these loans is guaranteed by the Government of Canada, producer organizations are able to obtain financing at a lower rate of interest — usually below prime — than would otherwise be the case. Minimizing interest costs is important, both to the federal government, which pays the interest on the first \$50,000 of an advance, and to those producers who take advances exceeding \$50,000.

Who is involved and their roles

11.13 The operation of the program involves the co-ordinated efforts of many groups, the most significant of which include participating producers, producer organizations, the Canadian Wheat Board, elevator companies, financial institutions, and Agriculture and Agri-Food Canada. The producer organizations play a very key role. In fact, one must exist in order for the cash advance program to be offered for a particular storable crop. These organizations perform several important administrative functions, including:

- arranging for the cash advance loans from a lender;
- negotiating a cash advance guarantee agreement with the Department;
- ensuring that the eligibility conditions are met before advances are given; and

- ensuring that the advances are repaid.

How producers market their products

11.14 There are essentially three ways that producers market their products; these are described in Exhibit 11.2.

Exhibit 11.2

Product Marketing

Approach of Producer Organization	Description	Examples of Producer Organizations
Single Desk Selling	<p>The product is marketed and sold by the producer organization. Revenues are generally pooled and producers are paid based on the grade and quality of their product. Producers receive payments from the producer organization, after a pro rata deduction has been made to repay a portion of the advance.</p> <p>In the case of the Canadian Wheat Board, elevator companies issue advances upon completion of an application by the producer. The elevator companies also pay producers a net amount at the time grain is delivered to them, after deduction of a pro rata repayment of the producers' cash advance. The Canadian Wheat Board reimburses the elevator companies for the moneys advanced and interest costs.</p>	Canadian Wheat Board BC Tree Fruits
The crop is sold by the producer under terms of a contract with a specific buyer	Prices are generally negotiated by producer representatives, while quantity and delivery dates are generally negotiated by individual producers. Payment is made to the producer by the contractor. Contractors often will withhold a portion of the sale price and remit this to the producer organization directly, representing repayment of the advance.	Keystone Vegetable Producers (Manitoba potatoes) PEI Potato Board (process potato sector only)
Producers find their own customers	Customers may be elevator companies, dealers, wholesalers, processors, feed lot operators or livestock producers. Prices can fluctuate on an hourly or daily basis and may vary between similar buyers. Some buyers may withhold repayments on behalf of the producer organization, but in some cases the producer is responsible for repayment of the advance directly to the producer organization.	Canadian Canola Growers Ontario Corn Producers PEI Potato Board (seed and table potato sectors)

Source: Discussions with producer organizations and individual producers

The amounts guaranteed are significant

11.15 The value of advances guaranteed by the federal government fluctuates, depending on participation rates, product prices and product volume. Nevertheless, the total amount guaranteed is significant. In recent years, the maximum amount guaranteed has varied from \$730 million to over \$1.2 billion. The value of cash advances for Canadian Wheat Board grains exceeds those issued for other crops, by a large margin.

11.16 Exhibit 11.3 demonstrates that year-to-year variation in amounts advanced can be quite large, particularly for advances made to producers of Canadian Wheat Board grains. Officials at the Canadian Wheat Board identified

the following factors that account for these variations: weather conditions at harvest; quantity and quality of harvested grain; availability of early delivery opportunities; costs of production inputs; trends in grain prices; and other financial pressures.

Exhibit 11.3

Cash Advances, 1992-98

Crop Year	Cash Advances Issued for Canadian Wheat Board Grains (\$ millions)	Cash Advances Issued for Other Storable Crops (\$ millions)	Total Cash Advances Issued in Crop Year (\$ millions)	Defaults (\$ millions)	Government Interest Costs (\$ millions)
1997-98	533	237	770	Not yet available	Not yet available
1996-97	875	272	1,147	28.0	16.3
1995-96	542	212	754	7.0	18.3
1994-95	524	206	730	11.3	21.2
1993-94	819	150	969	62.6	13.4
1992-93	1,081	122	1,203	46.8	46.2

Source: Agriculture and Agri-Food Canada

11.17 The manner in which prairie grains are marketed in Canada has a major impact on grain producers. In any given year, roughly 28 million tonnes of grains are produced that are marketed through the Canadian Wheat Board. However, the grain transportation system has a maximum capacity at any one time of about 5–6 million tonnes of product. This means that farmers cannot deliver all of their grain at harvest, even if they wanted to. They must provide for on-site storage of their product until the Canadian Wheat Board is able to sell their product and arrange for shipment to the buyer.

11.18 The government incurs three types of costs to deliver this program: interest costs on the first \$50,000 advanced; the costs of making good on the principal and interest of any defaults on the funds advanced; and the costs of administering the program. The Department made a commitment to Cabinet to limit average spending on interest and administrative costs to \$40 million a year over the next three years. The funding for these costs comes from the Department's "safety net" envelope of funds, the source of funding for departmental income stabilization programs.

11.19 Exhibit 11.4 provides general information about the size of cash advances and the financial benefits they provide for two typical groups of producers currently participating in the program. As might be expected, the interest benefit varies depending on the interest rate obtained by the producer organization, the amount of the advance and the average period the cash advance was outstanding.

Exhibit 11.4

Cash Advance Impacts

	Canola	PEI Potatoes
Cash Advance ¹	\$22,465	\$44,075
Interest Paid by Government ²	\$550	\$1,675
Interest Cost if Producer Must Borrow Him/Herself ³	\$825	\$2,025
Administrative Fee Paid by Producer	\$150	\$250
Net Interest Saving to the Producer	\$675	\$1,775

Notes:

^{1,2} Average amounts calculated using actual results for 1995-96. Interest benefit for PEI potatoes is proportionally greater than for canola because advances are usually of longer duration.

³ Using prime (7.5% in 1995-96) + 1.25% as an average interest rate

Source: Agriculture and Agri-Food Canada

Cash advances are seen as an important sign of government support

11.20 The cash advance program has been very well received. Of the producers we contacted, most liked the availability and predictability of cash flow at harvest time, and the interest-free benefit. Producer organizations endorse the program because it encourages participation in their organization by producers. The program appeals to many elected officials because it has achieved a high degree of support in the agricultural community while its annual costs are seen by many as relatively low.

11.21 In recent years, producers have been encouraged to become more market-oriented and more self-reliant. Most of the large subsidy payments of the past — including the Crow benefit, Feed Freight Assistance and other large ad hoc payments — have either been discontinued or are being phased out over time. Yet the cash advance program has survived these changing times, and today is seen by many producers as an important sign of government support to the storable crops sector.

11.22 The program is currently provided under the authority of the *Agricultural Marketing Programs Act (AMPA)*, which was passed in 1997. Although the *AMPA* refers to this as an “advance payments” program, in this report we refer to it as the cash advance program — the terminology commonly used by producers.

11.23 Previously, two cash advance programs operated under separate authorities, the *Advance Payments for Crops Act (APCA)* and the *Prairie Grain Advance Payments Act (PGAPA)*. A third authority, the Cash Flow Enhancement Program (CFEP), provided for payments under the interest-free feature of the program. In 1997 these authorities were updated and consolidated within the *AMPA*, in order to:

- eliminate inequities between the *PGAPA* and the *APCA*;
- reduce loan defaults by making producer organizations more accountable for proper administration and control over advances made to their members, including a provision that these organizations cover a percentage of any defaulted advances; and

- make permanent in legislation the interest-free provision.

From a producer's perspective, however, the basic operation of the cash advance program has remained unchanged.

The purpose of the cash advance program

11.24 It is important to understand what the cash advance program is intended to achieve. Exhibit 11.5 describes recently available information about the intended objectives of the cash advance program.

Exhibit 11.5

Statements About the Objectives of the Cash Advance Program

What the *Agricultural Marketing Programs (AMPA) Act* says:

The preamble to *AMPA* describes it as “*an act to establish programs for the marketing of agricultural products . . .*”. Part I of the Act, which deals exclusively with cash advances, states, “*The purpose of this part is to improve marketing opportunities for crops of eligible producers by guaranteeing the repayment of the advances made to them as a means of improving cashflow at or after harvest.*”

What the Department's Website (ACESIS) says:

[The cash advance program] provides cash advances with an interest-free feature on the first \$50,000 to eligible producers to store eligible crops after harvest, allowing them to market the crops later in the season when the market conditions may result in better prices and thereby encouraging the orderly marketing of the crop.

Information Provided in the 1996-97 Estimates:

- Cash flow programs are designed to assist producers in having a more consistent and reliable cash flow from the sale of products.

Source: Agriculture and Agri-Food Canada

11.25 Although these are somewhat different statements, the key elements seem relatively clear:

- It is a marketing program first and foremost.
- It has an objective of improving marketing opportunities.
- Improving cash flow at or after harvest is the means by which the program improves marketing opportunities.
- The government guarantee of repayment of the advance encourages lenders to provide cash advances, and these advances improve cash flow.

Focus of the audit

11.26 Since the legislation governing the cash advance program was recently revamped, and considering that the federal role in program administration is relatively limited, we concluded that the most significant issues were primarily related to program effectiveness. We focussed our efforts on determining whether the Department:

- had sufficient information about the effectiveness of the program;
- had adequately disclosed what it knew of the effectiveness of the program to Parliament and other interested parties outside the Department and whether these practices were indicative of the dissemination practices used for other effectiveness studies and analyses; and
- was properly controlling financial risks to the Crown, particularly from loan defaults.

Further details on the audit are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Information on Program Effectiveness

The Department has gathered important information about the program's effectiveness

11.27 The Department's Review Branch completed an evaluation of the cash advance program in 1993. The evaluation scoped in all relevant elements of the program at that time, including the *Prairie Grains Advance Payments Act*, the *Advance Payments for Crops Act* and the Cash Flow Enhancement Program. The Department's methodology incorporated several complementary lines of enquiry. These included a review of documentation, case studies and extensive fact finding with key stakeholders including producers, producer organizations, processors and processor organizations, federal and provincial government departments, and the banking community. The methodology also included an independent review of the work by a leading agricultural economist. An advisory group representing many of the program's stakeholders oversaw the study.

11.28 We reviewed the evaluation, using procedures summarized in Exhibit 11.6.

Exhibit 11.6

Our Evaluation Review Procedures

To satisfy ourselves as to the appropriateness of the 1993 evaluation findings, we reviewed the Department's methodology for conducting the evaluation and looked at the relationship between the evidence acquired and the conclusions reached.

To test the reasonableness and continued relevance of the findings, we interviewed departmental officials, representatives of producer organizations including the Canadian Wheat Board, producers (by telephone and in person, including program participants, non-participants and ex-participants), members of the Canadian Bankers Association and other financial institution staff, and those involved in the original evaluation. We also reviewed pertinent documents provided to us by the Department, and the extent to which other studies and departmental experience corroborated the findings.

11.29 We concluded that there was appropriate and adequate support for the findings of the evaluation, and that these findings had been reached through the use of sound methodology. Nothing came to our attention to suggest that the evaluation findings were unreasonable or no longer relevant.

11.30 The evaluation furnished important information about the program's effectiveness but, as in any study, some questions remain unanswered. These are discussed more fully later in this chapter.

Evaluation identified some significant concerns about the program

11.31 The findings of the 1993 evaluation noted that producers and their respective organizations were very satisfied with the design and delivery of the cash advance program. As well, the evaluation found clear evidence that the government guarantee leads directly to lower borrowing rates for producers.

11.32 In a series of evaluation case studies of specific commodities, producers and producer organizations stated that the program enabled them to avoid dumping at harvest time when prices may be low, and to receive a higher and more stable price for their crops. Producers reported that the program has led to lower interest rates and improved relations with their bankers. Producer organizations believed they also have benefited from the program

by being able to provide an additional value-added service to their members. Through the program, they learn more about their members' needs and increase their visibility to their membership.

11.33 At the same time, the evaluation also raised significant questions about aspects of the program's effectiveness, notably the following:

- There was a need to articulate a policy that clearly outlines the rationale for the program.
- There was no firm evidence that the program contributes to orderly marketing, and the incremental effect is likely minimal.

11.34 In addition, the evaluation expressed particular concern about the interest-free nature of the program, questioning the need for this feature: if the program provides producers with financing not otherwise available, allowing them to increase market returns, why would they need an interest-free incentive to participate? The evaluation suggested that the interest-free benefit serves as a form of income support.

11.35 Exhibit 11.7 elaborates on these findings, using extracts from the evaluation report.

Exhibit 11.7

Key Extracts from the 1993 Evaluation

Relating to Improved Marketing Opportunities

"Analysis of the effect of the *Advance Payments for Crops Act* on prices was inconclusive, confounded by other factors and restricted by the limited participation in the program."

"The evaluation found no firm evidence that these programs contribute to orderly marketing. However, . . . it is likely that more orderly marketing occurs with these programs than would occur without them, even though the incremental effect is probably minimal."

Relating to Increased Cash Flow

"The *Prairie Grains Advance Payments Act* serves producers by alleviating cash flow problems caused by the lack of delivery opportunities as a result of limited quotas or transportation handling constraints."

"The program allows the Canadian Wheat Board to extend advances at a very favourable interest rate."

Relating to the Interest-Free Benefit

"A distinction needs to be made between advance payments — the tool for cash flow enhancement and orderly marketing — and the interest-free benefit of the program, which provides income support."

"Analysis showed that there is little economic justification for making advances interest-free — there is no evidence that there is a need for the Cash Flow Enhancement Program (CFEP) (i.e. the interest-free benefit) or that it actually promotes orderly marketing — except that the effect of CFEP in making advances interest-free serves as an incentive for participation in advance payment programs."

"If participation in advance payments is dependent on the availability of the [interest-free benefit], this suggests that producers see little need for advance payments in themselves."

"Evaluation interviews also suggested that there would be drastically reduced participation in the programs unless the cash advances are interest-free or have a substantial interest rate benefit. This argument suggests that either:

- farmers have sufficient resources of their own to carry the crop or they can obtain financing at acceptable rates from commercial sources — that is, there is no cash flow problem; or
- the benefit of holding the crop is, at best, little more than the interest cost — that is, the net increase in revenue is so small that if interest costs must be paid, there is no incentive to hold the crop.

In either case, the need for government subsidized advance payment programs is questionable."

Source: Agriculture and Agri-Food Canada - Executive Report: Evaluation of the Advance Payments Program (1993)

Other concerns have been raised about the program

11.36 The 1993 evaluation is the most comprehensive study of the effectiveness of the cash advance program, but it is not the only one.

11.37 In the mid-1980s, the Nielsen Task Force examined the two existing cash advance programs. The Task Force concluded that the Canadian Wheat Board could operate its own cash advance program, if one were needed. In the case of the *Advance Payments for Crops Act*, the Task Force concluded that the interest subsidy could be cancelled and that an advance payments program at market interest rates could achieve the same marketing objectives.

11.38 In 1989, the government of the day decided to end the practice of paying the interest costs on the first \$50,000 advanced to producers. Elimination of the interest-free benefit, although only one of several contributing factors, corresponded with a significant drop in participation in the cash advance programs in the 1989 crop year. Producers opposed the cancellation of the interest-free benefit and, one year later, the benefit was reinstated through the creation of the Cash Flow Enhancement Program.

11.39 Several current and former senior officials of the Department with an intimate knowledge of the cash advance program expressed concerns to us about the program's effectiveness. We also found departmental documents that suggest that the program does not sufficiently meet the six tests set out in the government's recent Program Review exercise: serving the public interest; necessity for government involvement; appropriate federal role; scope for public sector/private sector partnership; scope for increased efficiency; and affordability.

11.40 Given that the Department had important information about the program's effectiveness, and that the program was not significantly altered in the revamping of the legislation, we examined what the Department did to:

- clarify the program's objectives and rationale, as the evaluation had recommended; and
- make effectiveness information available to parliamentarians and others outside the Department with an interest in the program's effectiveness.

Program's rationale was not sufficiently clarified

11.41 The first recommendation of the 1993 evaluation emphasized the need to develop a clear policy rationale for the cash advance program — one that distinguished between marketing, cash flow and income support objectives. In its response to the evaluation report, the Department made a commitment to clarify the program's rationale during the legislative review.

11.42 As noted earlier, the overall objective of the program as set out in the *Agricultural Marketing Programs Act* is relatively clear. However, the government has not made clear why advances are provided interest-free. This is despite the evaluation's finding that a clear articulation of the policy rationale for this part of the program was needed, which was also the conclusion of a 1993 departmental internal audit of the Cash Flow Enhancement Program. This is significant because making the interest-free benefit a permanent feature of the program was a driving force behind the new legislation.

11.43 The only public indication we could find of a possible intent of the interest-free benefit was contained in the 1993 election platform of the government. It suggested that the intended purpose of the program was to reduce interest costs as a way of offsetting the rising costs of farm inputs. This view of the program is similar to that of the 1993 evaluation, which saw the interest-free benefit as a form of income support. Some departmental officials told us that they do not consider the interest-free component to be intended as income support. However, officials were unable to provide any public or internal statement of the intent of this provision.

11.44 It is important for the Department to clarify the objectives for this aspect of the cash advance program because it is a prerequisite to evaluating its effectiveness. Arguments can be made both for and against the interest-free aspect of the program, but without a clear idea of what it is meant to accomplish, meaningful debate about its merits is hampered.

11.45 Although the recommendation of the evaluation to develop a clear policy rationale for the program was not entirely implemented, we noted that, in revamping the legislation, the Department did act on other key recommendations of the evaluation.

Public Reporting of Departmental Effectiveness Studies

This case illustrates limitations of public reporting of departmental effectiveness studies

11.46 The Department included a summary of the evaluation findings in the 1994-95 Estimates Part III, reproduced in Exhibit 11.8. This practice complies with Treasury Board requirements. It was the only public reporting of the existence of the evaluation and its findings.

Exhibit 11.8

Summary of the 1993 Evaluation Study in the 1994-95 Estimates Part III

The evaluation found that there is strong support from stakeholders for the continuation of the programs, and producers' motivation for participation is primarily cash flow. The evaluation also showed that the programs are potentially effective in promoting orderly marketing, but that the means used by the programs, for example, cash flow assistance and income support, have become confused with the underlying goal of orderly marketing. It was also noted that there is a need for a clear articulation of the policy rationale for the programs, as well as a need for modifications to the programs to link them more closely to their marketing objectives and make them more responsive to producers' needs.

Source: 1994-95 Estimates Part III

11.47 The case of the cash advance program illustrates why these summaries, although useful, ought to be augmented by other means of alerting those outside the Department to the existence and findings of evaluations:

- There are many topics covered in Estimates documents, so summaries are necessarily short and high-level. They cannot be expected to provide full information about all significant aspects of program effectiveness. In this case, the summary does not mention some of the key findings outlined in Exhibit 11.7 — particularly the issues raised about the interest-free nature of the program.
- The Estimates summaries alert parliamentarians and stakeholders to the existence of an evaluation, and give an overview of the findings, so that parliamentarians, their staff and others can request further information or a copy of the study. But in this case, by the time the new legislation was before the House, more than three years had passed since the summary had been published. As documents of record, the Estimates are available for searching electronically and in hardcopy. However, this span of time increases the chances that parliamentarians, their staff and committee researchers might not have been aware of the existence of the evaluation during the course of deliberations on the legislation.

11.48 **Strong arguments exist for more actively disseminating departmental effectiveness studies.** We believe that there are a number of characteristics of the Department, the legislation it is responsible for administering and the nature of its stakeholder community that together create a strong case for more actively publicizing the existence and findings of departmental evaluations and other studies of the effectiveness of agricultural programs:

- There is an extensive network of agricultural producer and industry groups interested in the effectiveness of agricultural programs, along with a relatively large community of agricultural economists who research the effects of agricultural programs. These groups and others engage in active public debate about the merits of various agricultural programs.
- The Department is in a unique position to contribute to debate on the impacts of agricultural programs, recognizing that information on program effectiveness improves the quality of public debate by providing a factual basis for debate between program proponents and opponents. For example, the Department has access to considerable administrative data that are invaluable in such studies. Indeed, the Department produces numerous studies on the impacts of agricultural programs, particularly in its Policy Branch, which is one of the largest policy branches in the federal government.
- Many departmental programs have sunset provisions or built-in five-year review requirements creating opportunities for debate on the effectiveness of these programs.
- The Department conducts extensive consultations on the future direction of its programs, for which information on actual program impacts may modify or strengthen the views of those consulted.

For these reasons, we believe that the Department ought to augment its dissemination efforts in two key ways.

11.49 Better information dissemination at the time of parliamentary reviews and stakeholder consultations.

First, at the time of legislative reviews by Parliament (for example, when legislation is revamped as with the cash advance program, or when parliamentarians are examining the results of five-year reviews of agricultural programs), we believe that the Department should inform parliamentarians of effectiveness information it has obtained about the program in question. This can come from evaluations, other studies or ongoing performance measurement. The Department ought to offer to provide briefings and supporting documents about this information to parliamentarians and staff. Parliamentarians have repeatedly said that they are interested in receiving evaluation information, a view confirmed in the April 1997 Sixty-Fourth (“Catterall”) Report of the Standing Committee on Procedure and House Affairs.

11.50 Similarly, we believe that the value of departmental consultations would be enhanced by providing those consulted with information on what is known about program effectiveness. The Department often undertakes consultations with stakeholders concerning the future direction of agricultural programs. In the case of the cash advance program, a very comprehensive series of consultations were held before the legislation was revamped. Those consulted were provided with extensive material outlining a number of possible options for the program. We believe that, in future consultations, augmenting such information with what is known about the program’s effectiveness would enhance the value of the consultation process.

11.51 In future parliamentary reviews and consultations with stakeholders on agricultural programs, the Department should provide briefings and supporting documents on program rationale and objectives, and on what is known about the program’s effectiveness.

***Department’s response:** The Department routinely provides stakeholders and the Standing Committee on Agriculture and Agri-Food with briefings and other sources of information that speak to questions of program rationale, objectives and effectiveness. For example, as part of the recent national safety net review consultations, Industry Advisory Committee members were provided with exclusive Internet access to all available departmental analysis of safety net programs. In all of its external communications and consultations, the Department strives to meet the information needs of parliamentarians and industry stakeholders while respecting legitimate international trade considerations, federal-provincial relations and Cabinet direction.*

In the case of advance payments, the 1993 evaluation was a catalyst that ultimately led the Department to embark on a comprehensive and, according to several industry leaders, effective national consultation process on options

for reform. Although the evaluation itself was not distributed, the Department's discussions with stakeholders were informed by its main findings/recommendations as well as a number of other information sources and other legitimate factors. One such factor was the 1995 Budget statement that, in keeping with a 1993 promise to the Canadian people, committed the government to bringing the interest-free feature of advance payments into legislative force.

The Department is committed to improving its formal parliamentary reporting practices, including the five-year review required under the Agriculture Marketing Programs Act. This commitment is evident in the Department's voluntary participation in the Improved Reporting to Parliament Project and in its ongoing implementation of a business line, results-based approach to managing and reporting.

11.52 Better ongoing dissemination of effectiveness information. Second, we concluded that the Department ought to be more proactive in disseminating evaluations and other studies of agricultural program impacts as they are completed. A number of concerned stakeholders told us that in recent years the Department has not been forthcoming in making these studies public.

11.53 As Exhibit 11.9 notes, we found two areas in the Department that had not been systematically disseminating studies but that have recently taken steps to make analyses and effectiveness studies available to interested parties outside the Department. These initiatives represent a promising new orientation toward openness.

Exhibit 11.9

Two Areas Where Dissemination Practices Have Improved

Economic and Policy Analysis Directorate

This group undertakes a significant amount of analytical work each year. Although some of it is focussed on providing direct support to policy analyses done on behalf of the Minister, it performs a significant amount of analysis that is less confidential and of potential interest to academics, industry, producer organizations and other stakeholders.

Until recently, the Directorate did not systematically disseminate its studies and analyses outside the Department. The Directorate has recently made a deliberate effort to establish a list of key stakeholders that are interested in their work. Further, it distributed a medium-term business plan to more than 700 of these stakeholders, outlining the studies the Directorate intends to undertake over the next three years. The Directorate now has the authority to release on its own a defined set of analyses. This is designed to encourage faster, more timely release of completed studies.

Furthermore, the Directorate is making access to approved studies more user-friendly than has been the case in the past, including providing access to studies through the Internet.

Farm Income Policy Directorate

For the negotiations currently under way with provinces and other stakeholders regarding the next generation of safety net programs coming on stream in 1999, this Directorate is making available to its partners recent studies, analyses and discussion papers prepared by the Department. In the past, distribution of this type of information was much more restricted.

Source: Agriculture and Agri-Food Canada

11.54 The initiatives of both Directorates are in their infancy and, therefore, it is too early to draw definitive conclusions on their impact, or on whether they will effectively address stakeholders' concerns. As well, these initiatives have been limited to those two areas. Studies on the impacts and effectiveness of departmental programs are undertaken elsewhere in Policy Branch, in the Review Branch and by program management.

11.55 Review groups in a number of other departments have taken proactive steps to alert outsiders to the existence and findings of effectiveness studies; for example, some groups have made entire evaluation reports or their executive summaries available on departmental websites or on a Treasury Board Internet data base of

evaluations and reviews. As in the case of the evaluation of cash advances, the Department publicly reports effectiveness studies in a one- or two-paragraph summary in departmental Performance Reports in the Estimates, without references to how more detailed information can be obtained by those interested. This same summary is the extent of the information that the Department provides on the Treasury Board Internet data base. Adopting the practices of these other departments could enhance the ease of access by outside parties to the findings of departmental effectiveness studies.

11.56 Other inexpensive means are available that would increase the likelihood of interested stakeholders becoming aware of effectiveness studies and would make access to these studies easier for those interested in more detailed information. For example, it would be a relatively simple matter to create a list of interested stakeholders (as the Economic and Policy Analysis Directorate has done) and alert these stakeholders by mail, facsimile or e-mail when particular effectiveness studies have been completed. As a further example, the studies could be included in the catalogue of publications available to the public from the departmental Publications Service.

11.57 Again, the Department's existing practices meet the specific requirements of Treasury Board policy. However, the additional steps noted above represent practices that are consistent with the Treasury Board policy's thrust toward making reports readily accessible to the public, and already are being initiated in two areas of the Department.

11.58 **The Department should implement practices to better alert interested stakeholders of the existence and findings of evaluations, ongoing performance measures, and other studies of program impacts. These practices should include:**

- **providing information on how more detailed information can be obtained (in addition to the summary of study findings in departmental Estimates documents);**
- **publicizing the list of completed studies;**
- **developing and maintaining a list of interested stakeholders and notifying stakeholders about completed studies; and**
- **examining the feasibility of additional vehicles to disseminate information, including the Internet.**

Department's response: As the audit notes, the Department's current dissemination practices comply with the Treasury Board Policy on Review. Nevertheless, the Department is committed to finding new and better ways to serve the emerging information needs of its clients.

Over the coming months, the Department will be consulting with its stakeholders in order to gain a better appreciation of those information needs, expectations and dissemination preferences. The above-noted suggestions for improvement will be implemented to the extent that they are consistent with stakeholder interest in receiving evaluations, audits and program impact studies conducted by the Department.

Information on Cash Advances Is Needed for the Future

11.59 In the new *Agricultural Marketing Programs Act*, Parliament reaffirmed its belief that periodic reviews of programs are an important tool for oversight. A provision was incorporated in the Act requiring, "During the fifth year after this Act is assented to, the Minister must review the provisions and operation of this Act in consultation with the Minister of Finance." The fifth year of operation will begin in 2001.

11.60 The 1993 evaluation provided important information about the program’s effectiveness but, as with any study, some questions remain unanswered. We believe the Department needs to begin to develop an appropriate framework for this review and to identify the types of data it will need to complete the review. This would help ensure that the information required is available when needed. At the time our audit was being completed, departmental officials informed us that work was beginning in the Review Branch on an evaluation framework of the program in preparation for the five–year review.

11.61 In addition to clarifying the rationale for the program, as discussed earlier, there are a number of questions that the Department ought to explicitly address in the five–year review, if not earlier.

Do cash advances provide producers with additional credit availability?

11.62 The extent to which the cash advance program gives loans to producers that would not otherwise be available is key to the program’s effectiveness. If it does serve this purpose, it would represent a significant benefit to producers. If it does not, then the value of the program in improving marketing opportunities would be questionable, since producers could use other financing to allow them to market crops later in the season.

11.63 The 1993 evaluation did not address this issue in depth. It did, however, raise important questions about the matter. Noting that participation would likely be “drastically reduced” without the interest benefit, the evaluators suggested that either producers already have adequate financing available, or that increased returns from delayed marketing do not cover the cost of interest. The Department was unable to provide us with any other studies or analyses about whether there is indeed an “access to credit” problem at harvest time.

11.64 We believe that there is a need to examine this issue more comprehensively in time for the five–year review, both because of questions raised in the evaluation and because of statements made to us by producers and banking officials during our work.

11.65 One aspect of this issue is whether those who already have access to credit from existing sources can obtain an increased amount by virtue of this program. Many producers use operating lines of credit to finance their input costs until the crop can be sold. Operating lines of credit are secured in whole or in part by the value of the producer’s crop. When a cash advance is obtained, the financial institution is required to give the federal government priority over the bank’s claim to this collateral. As a result, the collateral is no longer available to secure the operating line of credit. Producers and banking officials told us that if producers have fully used their available operating line and then obtain a cash advance, the bank generally requires the producer to reduce the operating line by using a portion of the cash advance. If the bank does not reduce the operating line, then this indicates that the bank would have been willing to increase the operating line by at least the amount of the advance, had the producer asked.

11.66 In other words, if these reports are correct, the program may not be increasing the credit available to producers with operating lines. Selected remarks by producers are found in Exhibit 11.10.

Exhibit 11.10

Producers’ Remarks Made During Audit Interviews

“One of the disadvantages of the program is that the bank will limit your operating line.”

“If you are at your limit on your operating line, in effect your advance comes to you already made payable to the bank.”

“The interest–free benefit attracts me to participate. If this were removed, I’d shop around for the cheapest financing.”

“Financing is financing. If the cash advance program wasn’t free, I’d just keep going to my bank.”

11.67 It is also important to note that this program is not intended to finance producers who are poor credit risks. Indeed, the Department expects producer organizations to carry out credit checks on all producers before issuing advances. The program also requires producer organizations to cover a portion of defaults to help ensure that they do not take excessive credit risks.

11.68 It would be inappropriate to conclude from this limited evidence that the program does not provide additional financing to producers. These statements, however, do raise questions that suggest the need for a systematic analysis of actual participant financing experience to establish whether there is indeed a significant problem of access to credit at harvest time and whether the program provides significant additional financing to producers. Ongoing data needed for such a study could be collected when producers apply for an advance. The study could also examine how financing availability may vary over time. The last few years have been characterized by a relatively buoyant economy, and there is a feeling that credit availability declines in more difficult times. As well, interest rates have been low recently. If interest costs reach higher levels, credit may be available but less affordable to producers.

Does the program contribute to improved marketing opportunities?

11.69 Although the 1993 evaluation was unable to obtain hard evidence linking the cash advance program to improved returns to producers, it did note that most stakeholders and organizations are convinced that it does improve returns. Interviews we held with stakeholders suggest that this viewpoint is still widely held.

11.70 Given that the stated objective of the cash advance program is to improve marketing opportunities, we believe the Department needs to gather the appropriate data to demonstrate whether or not that is occurring, in time for the coming five-year review. We also believe that the Department could gather information that would shed light on this matter at a reasonable cost. A collaborative effort over several years may be necessary in order to ensure that sales history and related data necessary to address this issue are available.

11.71 An important aspect of this question is whether, beyond any benefits to individual producers, there are broader benefits to the market prices received by all producers because of the program. Some producers contend that dumping by even a small number of producers at harvest time can have a detrimental effect on prices for the entire season. If this is true, then providing some financial incentive to encourage program participation may well have a clear policy rationale.

Is the payback for producers better elsewhere?

11.72 The cost effectiveness of the cash advance program needs to be compared with that of other safety net programs. Because the safety net expenditures are capped, producers benefit if the money is spent on programming that provides the greatest cost effectiveness. This is especially relevant if the purpose of the interest benefit of the cash advance program is income support, as the 1993 evaluation suggested.

11.73 For the same reason, the program needs to be evaluated in comparison with other agricultural programs. In recent years, the Department and others have conducted studies that argue that returns on public expenditures strongly favour investments in productivity and growth-enhancing measures such as crop research and product/process development, with benefit-cost ratios many times that of income support programs.

11.74 As well, it may be that a more cost-effective program could be designed. When the administrative costs incurred by producer organizations, the Canadian Wheat Board and elevator companies are added to that of the federal government, the total annual cost of program administration is likely upward of \$5 million. These administrative costs might be reduced or better utilized under other program alternatives. For example, if it is determined that the program does not significantly increase the availability of credit, other program delivery options — such as paying a benefit directly to eligible producers — could provide interest rate relief while crops are in

storage. This could avoid the administrative cost of providing a financing mechanism already available from financial institutions, and avoid the costs incurred on defaults. Such options ought to be examined as part of the five-year review.

Is the Department managing losses well?

11.75 A major impetus behind the recent revamping of the legislation and consolidation within the *Agricultural Marketing Programs Act* was the desire to reduce losses due to defaults, that is, the amounts paid by the government to financial institutions for cash advances that have not been repaid. In the mid-1990s, the level of defaults, especially relating to the Prairie Grains Advance Payments program, threatened to undermine the viability of the entire cash advance program. When it became apparent that losses were becoming unacceptably high, the Department together with the Canadian Wheat Board took action to try to reduce the level of defaults. The changes they introduced to administrative practices contributed to reducing loan defaults from their peak of \$61.6 million in 1993-94. Exhibit 11.11 provides a recent history of defaults attributable to both Canadian Wheat Board grains and other crops.

11.76 The new *AMPA* legislation puts more onus on producer organizations to ensure that cash advances are made only to eligible producers. The government guarantee is effective only if the advances are properly administered. Producer organizations are now responsible for between 1 and 15 percent of the costs of any defaulted advances, with the percentage depending on the organization's historical loss experience. Once the government pays a default, it continues efforts to seek repayment from the producer.

11.77 Although Exhibit 11.11 indicates that defaults have improved in recent years, and the Department believes that its recent default performance is acceptable, it has no real basis for concluding so because it lacks any objectively determined benchmarks. For the same reason, we were unable to determine if the Department was managing defaults sufficiently well. It does not have adequate information in the following two important areas and, accordingly, is not able to draw conclusions about how well it is managing defaults.

- The Department has no rational basis for predicting what ultimate losses are likely to be. It currently manages defaults more than it manages losses (the ultimate cost of these defaults, after the Department has exhausted collection avenues). Having reliable information on estimated losses is important for putting defaults in perspective.
- The Department has no meaningful performance targets for program losses, but it could develop some easily using the commercial banks for benchmarking purposes. Bank operating lines of credit are secured by the same collateral as cash advances, and the cash advance program is not intended to give money to poor credit risks. Therefore, it is reasonable to conclude that agricultural loan loss targets for the commercial banks would be an appropriate starting point for determining an appropriate departmental target.

Exhibit 11.11

Recent Default Performance (\$ millions)

Year	CWB Grains	Other
1996-97	26.1	1.9
1995-96	5.9	1.1
1994-95	10.5	0.8
1993-94	61.6	1.0

1992-93	45.5	1.3
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Source: Agriculture and Agri-Food Canada, Canadian Wheat Board

11.78 A recent Treasury Board submission by the Department illustrates the need for this information. The Department has decided to assume collection responsibility for all defaults relating to advances made through the Canadian Wheat Board. The Department estimated it would collect at least \$40 million of more than \$90 million in outstanding defaults under the *Prairie Grains Advance Payments Act* — but it had no objective data on which to base this prediction. Most of these defaults are now four to five years old, and are still outstanding despite existing set-off opportunities and other collection efforts that have already taken place. This estimate was basically nothing more than an educated guess. In reality, the feasibility of collecting such a large proportion of an aging debt is open to question. Indeed, departmental officials informed us that they no longer consider this to be an achievable target.

11.79 Developing appropriate information and performance indicators, as noted above, would assist the Department to assess how well it is managing losses, and demonstrate this in time for the five-year review.

11.80 In preparing for the five-year review of the cash advance program under the *Agricultural Marketing Programs Act*, the Department should:

- further clarify the policy framework that explains why the cash advance program exists and what it is intended to achieve;
- develop a review framework and identify the data and other information needed to examine the program's effectiveness in the five-year review; and
- complete the examination of the program's effectiveness and provide the findings to parliamentarians and departmental stakeholders.

Department's response: The auditors are aware that program management is already working with the Department's Review Branch to develop an evaluation framework and to identify information that should be collected in order to ensure proper analysis, performance measurement and reporting.

11.81 The Department should identify a set of suitable performance measures for the cash advance program, including measures for loan loss management.

Department's response: This is being done through the development of the above-mentioned evaluation framework and performance measures.

Conclusion

11.82 The cash advance program is well regarded by producers. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

11.83 Work done by Agriculture and Agri-Food Canada in 1993 to look at the program's effectiveness reached some positive conclusions about the program, but also raised some significant concerns, particularly with the interest-free nature of the program.

11.84 Under the *Agricultural Marketing Programs Act* passed in 1997, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness. However, as in any study, some questions remain unanswered, the answers to which are necessary for the Department to have sufficient information about the program's effectiveness.

11.85 The Department still needs to clarify the reason why advances are provided interest free. The Department also needs to establish benchmarks, without which neither management nor our audit could conclude whether loan losses are being properly managed.

11.86 It is important to be realistic about the role that evaluations and other forms of effectiveness information can play. They have a role within the internal management of government, providing advice on how policy and programs can be improved. They also have a role in informing parliamentarians, stakeholders and the public about the effectiveness of government programs. As noted in *Matters of Special Importance* in the 1996 Report of the Auditor General, effectiveness information does not replace judgments on the value of programs, but it allows these value judgments to be based on better facts and arguments. It enlightens — not ends — debate on the issues of the day.

11.87 We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are taking steps in this direction.

About the Audit

Objectives

The legislation governing the cash advance program was recently revamped and also requires a five-year review of the program. Given these circumstances and since the federal role in the program's administration is relatively limited, we concluded that the most significant issues were primarily related to program effectiveness. We specifically asked whether the Department:

- had sufficient information about the effectiveness of the program;
- had adequately disclosed what it knew of the effectiveness of the program to Parliament and other interested parties outside the Department and whether these practices were indicative of the dissemination practices used for other effectiveness studies and analyses; and
- was properly controlling financial risks to the Crown, particularly from loan defaults.

Scope

Our audit focussed on the *Advance Payments for Crops Act (APCA)*, the *Prairie Grain Advance Payments Act (PGAPA)* and the Cash Flow Enhancement Program (CFEP). In 1997 these authorities were updated and consolidated within the new *Agricultural Marketing Programs Act (AMPA)*.

We examined audit and evaluation reports completed by the Department, in particular focussing on an evaluation completed by the Review Branch in 1993. We conducted in-person and telephone interviews with a number of producer organizations, including the Canadian Wheat Board, as well as individual producers, financial institutions and officials from Agriculture and Agri-Food Canada. Further details about our approach are explained in Exhibit 11.6.

We examined the dissemination practices used for other departmental effectiveness studies, and selected practices in other federal departments.

Finally, we examined departmental practices for managing program loan losses and defaults.

Criteria

We expected the Department to:

- develop clear objectives, measures and a data collection methodology to allow for evaluations of the program;
- respond to and take action on the recommendations in the evaluations;

- share the results of evaluations of the program with parliamentarians and stakeholders;
- share relevant information from all evaluations and other effectiveness studies with affected parties;
and
- properly control financial risks to the Crown.

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Chapter 12

Creation of the Canadian Food Inspection Agency

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(Exhibit 12.3 is not available, see the Report.)

Creation of the Canadian Food Inspection Agency

Main Points

12.1 The federal government is considering the use of alternative service delivery (ASD) arrangements in order to improve service delivery. The Canadian Food Inspection Agency (CFIA) was the government's first legislated service agency; it was created as a departmental corporation and became operational 1 April 1997. Its primary responsibility is to contribute to food safety, plant and animal health as well as to facilitate trade in all areas by providing inspection and related services.

12.2 There was a clear rationale for creating the Agency, including a 30-year history of studies related to reorganizing the federal food inspection system and the government's commitment to a new and better way of delivering services. Senior officials of the three federal departments then involved in food safety inspection supported the initiative to create a single food inspection service. This initiative illustrated that change can be best introduced and sustained when there is a clear rationale that has the support of senior officials.

12.3 The designation of a structured and independent team was crucial to managing the move to agency status. The team's work was separate from the ongoing business of inspections and quarantine activities, so those services could continue without interruption throughout the creation of the CFIA.

12.4 One of the driving forces behind the move to ASD arrangements is their greater flexibility in human resource management. With the move outside the *Public Service Employment Act* and the change to separate employer status, the shift to a new human resources regime was one of the Agency's greatest challenges. The complexities entailed in creating a new human resource framework as a separate employer need to be recognized and planned for early in the change process.

12.5 In an area of shared responsibility such as food safety, roles need to be carefully defined and mechanisms established to resolve unanticipated problems. The establishment of an accountability framework was a key concern during the creation of the CFIA. Specific responsibilities for food safety were assigned to the Minister of Agriculture and the Minister of Health. Some operational details were still being worked out as new issues arose during the first year of operations.

Introduction

12.6 Since the early 1990s, the government has recognized the need in the public service for greater flexibility, innovation and focus on results. Pressures for change have included the size of both the deficit and the debt, as well as changing public perceptions and expectations about the role and performance of government. Faced with these pressures, the government has been reviewing the programs it delivers. In the process, it has been considering where alternative service delivery (ASD) approaches might be more conducive to efficiency and effectiveness than traditional delivery through departments and, at the same time, more responsive to the needs of Canadians.

12.7 It has used commercialization, for example, to transfer services from the public sector to the private sector, as it did in the sale of the air navigation system to NAV CANADA. The government also uses arrangements with partners outside government, such as private enterprise, community groups and non-governmental organizations. And it is making more use of partnering arrangements with other levels of government; an example is the arrangement with provinces to deliver labour market training. Government has established special operating agencies, such as the Passport Office. In addition, new service agencies are being created: the Canadian Food Inspection Agency (CFIA) is one, and there is legislation pending to establish a Canadian Parks Agency and a Canada Customs and Revenue Agency.

12.8 The government has decided that proposals to establish alternative service delivery agencies would be examined individually, and on a business case basis. The CFIA was the first major service agency legislatively established by the federal government in a very important area, Canadian food inspection and quarantine activities. There is an interest, including within the CFIA itself, in understanding what was learned during the CFIA's establishment and how these lessons can be used by the government as it continues to promote new governance structures through transformations of government programs to alternative service delivery mechanisms.

The Canadian Food Inspection Agency

12.9 The CFIA was established in 1997 by the *Canadian Food Inspection Agency Act*. It is a departmental corporation with separate employer status, listed in the *Financial Administration Act* (Schedule II). Its primary responsibility is to enforce standards described in legislation pertaining to food safety and to animal and plant health. It does this by providing inspection services such as registration of processing plants, inspection of domestic and imported foods, certification of exports, and quarantine.

12.10 The Agency is headquartered in Ottawa. It operates programs in all 10 provinces and the territories. The CFIA is moving to a regional structure with four centres of operations and 18 regions across the country. It has about 4,200 staff in 26 area offices, 185 field offices, 408 third-party establishments (such as slaughter establishments) and 22 laboratories and research facilities.

12.11 Prior to the creation of the CFIA, inspection and related services for food safety and animal and plant health were provided by Agriculture and Agri-Food Canada, Health Canada and the Department of Fisheries and Oceans. These three departments transferred about \$330 million and 4,500 full-time staff equivalents (FTEs) when the Agency was created. Of the total transfer, Agriculture and Agri-Food Canada contributed over 86 percent, Health Canada just over 3 percent, and the Department of Fisheries and Oceans about 9 percent. Exhibit 12.1 outlines the benefits expected from the transfer of these services to a single agency.

Exhibit 12.1

Expected Benefits of the Agency

Through a more effective, streamlined approach to food inspection and animal and plant health services, the CFIA is expected to enhance consumer protection and work closely with clients to increase market access for Canada's food and agricultural products.

The Agency:

- improves service delivery by providing a single contact for consumer and food industry clients' federal food inspection requirements;
- reduces overlap and duplication of services;
- enhances efficiency in the delivery of federal food inspection;
- supports a safe food supply through the use of science-based inspection programs;
- continues and enhances access to international markets for Canadian producers and processors;
- sets the stage for a national food inspection system.

Source: CFIA, Corporate Business Plan 1997-2000

Management and accountability framework

12.12 In keeping with the ASD approach, the CFIA has the flexibility to replace some traditional departmental approaches in managing its mandate.

12.13 Human resources. The legislation created the Agency as a separate employer under the *Public Service Staff Relations Act* (Schedule I, Part II). Separate employers are part of the federal public service and the employees are still public servants, paid from public funds.

12.14 Separate employers are delegated the authority traditionally assigned to the Treasury Board Secretariat to negotiate collective agreements directly with the unions and establish terms and conditions of employment. In consultation with others, the Agency determines its own compensation and classification systems and work force adjustment and travel policies, among others. It works with unions to explore flexibilities in areas related to terms and conditions of work to better meet industry demands.

12.15 During the first year of operations, the Agency remained under the *Public Service Employment Act*. On 1 April 1998, it became legally responsible for establishing its own staffing regime, which had the legal effect of moving it out from under the *Public Service Employment Act* and the staffing regime of the Public Service Commission.

12.16 Finance. Most government departments are funded annually through parliamentary appropriations. The Agency has the authority to spend its annual appropriations over 24 months rather than the traditional 12-month period. It has the authority to spend revenues it has generated (user fees), which represent about 12 percent of its budget.

12.17 Accountability. The accountability regime is a mix of new and traditional approaches to governance. The Agency's regime retains the principles of parliamentary accountability and ministerial responsibility. Two ministers are responsible for implementing the federal food safety program. The Minister of Agriculture is responsible for inspection activities; the Minister of Health sets food safety policies and standards in the area of human health, and assesses the effectiveness of the Agency's related activities.

12.18 The Agency’s management authorities are assigned to the President, who is appointed by the Governor in Council for a term not to exceed five years; the appointment may be renewed for one or more terms. Under the Act, the President is accountable for “supervision over and direction of its work and staff”, while the Minister of Agriculture is responsible for the “overall direction of the Agency”. The President submits to the Minister the Agency’s corporate business plan and annual report, which the Minister tables in Parliament.

12.19 The corporate business plan must be prepared at least once every five years. It is to include the Agency’s objectives, strategies, expected performance and budget information. The annual report must include audited financial statements, performance information against the objectives established in the corporate business plan, and an assessment by the Auditor General of Canada as to whether the performance information is presented fairly and is reliable.

Focus of Our Study

12.20 The focus of this study was to describe the reorganization of the federal food inspection system and the Agency’s progress during its first year of operations. In addition, the study identified a number of useful practices that were employed, and other practices to consider in establishing ASD arrangements.

12.21 Throughout the chapter, we frequently conclude our findings with a *useful practice* or a *practice to consider*. *Useful practices* are those that seem to have worked for the CFIA and that could be considered in other ASD arrangements, taking into account the specific circumstances of each case. *Practices to consider* are those that might have addressed some identified concerns but were not used in the CFIA case, or were used only to a limited extent. We suggest that they be considered by others involved in a similar move to agency status.

12.22 Further details on the study are found at the end of the chapter in the section **About the Study**.

Study Findings

Key Factors in the Agency’s Successful Creation

Rationale and support

12.23 Long history of identifying reasons to reform the food inspection system. More effective delivery of food inspection services by the federal government was an issue that had been examined in depth for decades. A series of internal studies and task force reviews had pointed to the need to rationalize the Canadian food inspection system.

12.24 Those reviews provided a solid rationale for resolving the long-standing problems associated with the federal food inspection system. The decision to move to a single food inspection system was delayed by concerns about departmental mandates, the lack of necessary resources and questions about the appropriate reporting structure.

12.25 The consensus needed to resolve these issues was not reached until 1995. This undertaking flowed from a number of federal initiatives, including the Program Review exercises, renewed efforts for intergovernmental co-operation and a move toward innovative service delivery. After the government made a commitment in November 1995 to change the existing program, events proceeded very quickly. Exhibit 12.2 describes the milestones in the creation of the CFIA.

Exhibit 12.2

Milestones

Date	Early History
1970-1985	Four key studies recognized that a single food inspection agency could provide benefits in co-ordinating food inspection activities.
1986	Interdepartmental Committee on Food Regulation (ICFR) established in response to Task Force on Program Review (The Nielsen Report, 1985).
1994	Auditor General critical of long-standing problems with food inspection system and unfulfilled mandate of ICFR.
1995	Federal Budget highlighted the need to improve the effectiveness and efficiency of the federal component of the Canadian food inspection system, including possible changes in organizational structure. Office of Food Inspection Systems (OFIS) established in May 1995 to review organizational options and conduct stakeholder consultations.
1995 - 1997	Recent Events
Nov. 1995	Program Review ministers endorse the creation of a single federal food agency, and the expediting of the initiative through a two-phased transition process.
Jan. 1996	Prime Minister approves initiative; Minister of Agriculture designated as responsible minister for the implementation.
Mar. 1996	Federal Budget announces plans to consolidate all federal food inspection and plant and animal health services into a new agency.
June 1996	Phase 1 complete - resources realigned between Agriculture and Agri-Food Canada (AAFC) and Health Canada (HC); health policy functions/resources to HC and inspection functions/resources to AAFC.
June-Aug. 1996	Legislative drafting process.
Sept. 1996	Prime Minister approves name of Agency and human resources regime; legislation introduced in House (Bill C-60).
Oct. 1996-Feb. 1997	Preparation of final Treasury Board submission establishing the Agency and transferring resources from AAFC and Fisheries and Oceans (DFO) to the Agency.
Mar. 1997	Approval of Treasury Board submission to make Agency operational; Bill receives royal assent on March 20.
Apr. 1, 1997	First day of operations under the CFIA; Phase 2 complete - joining of AAFC (including former HC) staff and DFO staff; President appointed.

12.26 Strong support from senior management was evident. The creation of a single food inspection agency from branches in three government departments required each department to transfer inspection programs and resources to the new Agency.

12.27 Department heads might be expected to protect their own organization and give lukewarm support to a new agency that would reduce their own resources and programs. This was not the case with the CFIA. Commitment by the government and the deputies and assistant deputy ministers involved was strong and consistent, and is considered by many to have been critical to the successful creation of the Agency. Their support was demonstrated through a variety of actions:

- encouraging co-operation and good working relations among the departments during the implementation phase;
 - providing financial and human resources to establish an independent implementation team;
 - agreeing to key steps in the implementation plan;
 - consistently communicating the strong support the Agency had among ministers and central agency officials;
- and
- giving priority to the early creation of the Agency.

Useful Practice: Ensure that there is a clear rationale for change that has the strong support of ministers and senior management.

Transition managed by a structured and independent team

12.28 Following the March 1995 Budget announcement of the decision to review the federal food inspection system, the Office of Food Inspection Systems (OFIS) was established in May 1995 to review organizational options with the three federal departments, industry, the provinces and other stakeholders. OFIS prepared a discussion paper that outlined four possible organizational options; this paper was the focus of stakeholder consultations across Canada. Subsequently, the government decided to create a single food inspection agency. OFIS was responsible for establishing the Agency’s framework and preparing for the start of business.

12.29 Throughout the period leading up to the creation of the CFIA, there was a strong commitment by OFIS and the parent departments to separate the work of the implementation team from the operations of the three affected departments. In this way the process of creating a new agency would not interfere with operations, and would ensure the continuity of food safety and quarantine programs. As a result, during the implementation period the inspection program continued to be delivered as before, and the implementation team was free to focus on creating the Agency. Exhibit 12.3 describes the structure used by OFIS. Two of the components of the implementation structure were OFIS and the “Group of Seven”:

Exhibit 12.3 is not available, see the Report.

- **OFIS** co-ordinated the changes required to move to the new Agency. It comprised 11 full-time professionals with experience in the three affected departments, in some central agencies and at the provincial level. The executive director of OFIS was the main conduit for communication with the central agencies and, in particular, the Privy Council Office. OFIS implementation teams were formed to cover the areas of human resources, accountability, financial management, and communications. Moreover, there were 20 additional subcommittees to work with the implementation teams, involving over 170 individuals.
- **Group of Seven** was the intermediary body that acted as a co-ordinating group. It was a consensual decision-making body chaired by the senior advisor of OFIS. It comprised the leaders of the four OFIS implementation teams and representatives from the three departmental committees, who acted as conduits between OFIS and their home departments.

Useful Practice: When it is essential to maintain uninterrupted service delivery, establish an implementation team structure separate from ongoing business. Ensure that the interests of the major affected organizations are represented on the team.

12.30 Timing of appointments is key. In creating a new organization, a key decision is when to appoint its chief executive officer. The appointment of a president–designate could be made at any time from the announcement of the intention to establish the entity until legislation is passed and the organization is up and running. On one hand, an early appointment provides a focus for decision making and allows the new senior executive a chance to shape the organization to his or her vision. On the other hand, in strained or particularly difficult circumstances an early appointment could exacerbate any disagreements among the affected departments and reduce the incentive to cooperate with the new appointee. As well, it could limit the effectiveness of the consensual approach adopted by the implementation team.

12.31 Senior government officials and OFIS members discussed the timing of the appointment of the Agency’s President. The President and Vice–President were first named as designated heads in February 1997 and then appointed on 1 April 1997, when the Agency began operations. This timing did avoid potential disagreements among the three affected departments, but there was a consequence: during the implementation process, there was no individual exclusively representing the needs of the future Agency in negotiating the allocation of assets.

Practice to Consider: Ensure that the needs and interests of the new organization are adequately represented prior to the appointment of the president or chief executive officer.

Consensual approach to decision making

12.32 The decision–making approach adopted by OFIS, the Group of Seven and the implementation teams was consensual. This approach was supported by OFIS management and facilitated by the fact that teams were non–hierarchical and generally worked collaboratively toward agreed goals. When consensus could not be reached, the issue was moved up for decision by the involved assistant deputy ministers — something that occurred only a few times.

12.33 This approach generated the broad discussion and debate that ultimately led to the key recommendations and decisions made in the implementation period. OFIS team members left their “departmental jackets” at the door and this, along with the consensual approach, helped them develop a collective understanding of their purpose — to develop the best framework for the Agency.

12.34 Some limitations to the consensual approach. In our interviews, some members of OFIS indicated that a consensual approach was not useful when dealing with controversial issues under pressures of a short time frame. These pressures often forced teams to work on issues as they arose, rather than on other important matters with long–term implications, such as the development of the corporate business plan, the employee classification system and the organizational structure.

Useful Practice: Encourage a consensual approach to building an operating framework for a new agency. This facilitates the involvement and buy–in of all participants, which is important when several organizations are involved. However, resolution of more controversial issues might be deferred in a situation of a compressed time frame.

Expertise in creating a new agency

12.35 Dedicated resources working together are required to carry out the work of setting up a new organization that has the flexibilities offered the Agency. While no blueprint exists for creating agencies outside the traditional departmental structure, there is considerable experience on which to build. For example, at present over 20 organizations have separate employer status. The federal government has also created new organizations by transferring programs from several other departments, as it did in the case of the Canadian Space Agency, and other

jurisdictions in Canada have established many agency-type organizations. We would expect that the expertise thus acquired would be sought out and used.

12.36 Limited ASD expertise on the implementation teams. Generally, those involved in the implementation process were at fairly senior levels in their departments and, in many cases, had strong technical or functional backgrounds that were relevant to the work involved in the implementation. However, their experience was generally limited to working within government departments and implementing existing policies. Few members had experience in setting up new organizations and establishing policies to reflect management and administrative flexibilities in keeping with the ASD approach.

12.37 Limited use of outside expertise. ASD arrangements need administrative regimes that are much more flexible in their design and operation. Drawing on relevant outside experience, whether from other government jurisdictions or the private sector, can provide important lessons and facilitate the implementation process.

12.38 Implementation teams carried out most of their work in-house. Few external experts were brought in to provide complementary conceptual or technical assistance in the implementation process, but those who were called upon did have relevant experience.

Practice to Consider: Make good use of experience and expertise from outside federal departmental administration when setting up new organizations with flexibilities beyond those of traditional departmental structures and central policy regimes.

Impact of compressed time frame

12.39 A tight time frame was imposed on the implementation team. It had only 13 months, from the March 1996 Budget announcement until the legislation received royal assent in March 1997. This tight time frame presented benefits and challenges. In our interviews, team members often noted that the time frames generated tremendous pressure on work teams and limited their time for dealing with difficult issues. For example, on 1 April 1997, many Agency systems were not yet in place, including financial and human resource systems. By 1 April 1998, the transition process was still under way for the corporate management groups, which were increasingly occupied with delivering services while still having to develop internal policies and processes.

12.40 A deliberate decision was made to leave the details of the financial transfers and the human resource framework until after the launch of the new agency. This led to a phased-in approach. Issues and details that could not be resolved before the legislation was passed and that were not crucial to the legislation were deferred.

12.41 At the same time, the tight schedule certainly focussed attention on the task at hand and kept up the pressure to deliver the Agency on time. Given the narrow window open in the parliamentary agenda as well as a pending election, there was real concern that taking time to resolve all issues would mean having no agency at all.

Useful Practice: Implement a new agency through a phased-in approach as a way to deal with tight time frames. This allows implementation to proceed on time, even when there is insufficient time to deal with all issues or when complete agreement on all aspects of the agency has not yet been reached. However, unresolved issues can take significant effort to settle later on.

Effective communication and consultation about change

12.42 OFIS and the parent departments communicated throughout the implementation to ensure the involvement and support of working-level personnel, as well as other interested parties including consumers, industry and

foreign governments. Communication initiatives were viewed as a success by many stakeholders and staff involved in, or affected by, the implementation process. Our own study largely corroborates this view.

12.43 During our interviews, staff confirmed that OFIS and the parent departments had provided them with sound information. While they considered that the information provided was honest, there was often little information to share, given that many decisions were left until later. The fact that OFIS and parent departments were still able to marshal staff support and maintain trust throughout this organizational change is a major indicator of the success of the communication exercise.

12.44 Consultation with stakeholders was undertaken and was integral to the development of the Agency. In 1995, for example, OFIS used a consultative process to elicit comments and ideas about organizational options for reorganizing the federal food inspection system. Based on extensive consultations with the three federal departments, industry, provinces, and other stakeholders, the government opted for the creation of a single agency.

12.45 Throughout the implementation period, there were efforts to consult with affected groups prior to making decisions. The implementation team's firm commitment to an extensive process of consultation has been widely recognized.

Useful Practice: Implement a communication strategy that incorporates consultation as a meaningful tool to involve employees and stakeholders — a key element in the successful implementation of a new service agency.

Key Challenges

Transfer of program and corporate assets to the new Agency

12.46 The process of identifying and allocating resources to the new Agency from the three affected departments proved to be complex and time-consuming. The new Agency would need to receive sufficient resources to establish a solid basis for fulfilling its mandate, including inspection resources, corporate overhead and physical assets such as buildings and laboratories. Similarly, the contributing departments had to be left with appropriate resources to deliver remaining programs.

12.47 A number of factors in the CFIA experience affected the transfer process:

- It was a two-staged implementation — the realignment of Health Canada and Agriculture and Agri-Food Canada program components in June 1996, followed by the transfer of the Fisheries and Oceans and Agriculture components to the Agency on 1 April 1997.
- The inspection components in Agriculture and Agri-Food Canada and the Department of Fisheries and Oceans were largely self-contained and separate from other operations in those departments.
- Given the scope and complexity of Health Canada's planned laboratory rationalization, a decision was made to defer the distribution of corporate and physical assets related to facilities until after the Agency's creation.
- All parties recognized the need to maintain long-term working relations.

12.48 **A structured approach was used to transfer program resources.** The accountability implementation team prepared an exhaustive list of the 51 federal activities in the three departments associated with food safety policy and standard setting, food inspection, and quarantine. As well as identifying who would become responsible for each activity on 1 April 1997, this accountability matrix was used to clarify shared roles and responsibilities. It

was also used in deciding on the transfer of program resources. With the transfer of each activity, the transfer of program dollars followed. Based on the agreed responsibilities, the accountability implementation team then allocated these activities to either the Agency or Health Canada.

12.49 Fixed assets were not valued, partly because the creation of the CFIA was not a sale of assets. Beginning with the fiscal year 1999-2000, the Agency intends to report its financial results using generally accepted accounting principles. At that time, it must value its assets. The task of valuing assets is difficult for any government entity, particularly when inventory records are incomplete or outdated. The Agency does not have a complete list of its assets. Given that the inspection programs transferred from parent departments were largely self-contained, however, all fixed assets such as laboratories, cars and equipment followed the program dollars and staff moving to the CFIA.

12.50 At the request of OFIS, the three departments hired an outside accountant who reviewed the figures used in the transfer process. Participants confirmed that this, coupled with sign-off on the accountability matrix by the Assistant Deputy Minister Steering Committee, enhanced credibility and added discipline and rigour to the process of transferring program resources.

12.51 The human resources implementation team developed criteria to identify those who would move to the Agency. Individuals who devoted 60 percent or more of their time to inspection services were designated a dedicated resource and were transferred. In some cases, non-dedicated staff (those devoting less than 60 percent of their time to inspection programs) were given the option to volunteer for transfer to any vacant positions. In other cases, transfers of staff were not feasible from the perspective of the parent department, and so dollars were transferred instead. This approach was not used to identify staff when they belonged to largely self-contained inspection units.

12.52 Division of corporate resources was difficult. The transfer of corporate resources was, however, difficult and continued to create problems for the Agency in the first year of operations. Many factors contributed to the difficulties. First, corporate staff are often multi-tasked and not easily separated from the parts of the organization that are not being transferred. Second, the implementation team did not use an agreed formula or methodology. OFIS proposed a formula based on a 1995 study that had been commissioned to project cost savings possible through a single-agency delivery system. However, there was no agreement to use this study in deciding on the allocation of corporate assets from the contributing departments to the Agency.

12.53 The absence of decisions about the future management structure of the Agency made discussion about a corporate structure difficult. No formal analysis of the Agency's corporate requirements was carried out. As noted already, there was no designated individual representing exclusively the Agency's interests to negotiate the transfer of corporate assets and ensure that the Agency would have enough resources to fulfil its mandate. Finally, the outside accountant who was hired to oversee the figures used in the transfer of program resources did not play a significant role in the division of corporate assets.

Useful Practice: Based on a needs analysis, establish a framework or formula to identify both program and corporate resources to be transferred from existing organizations to a new agency and ensure that there is commitment to transfer resources according to the formula.

Establishing a new human resource management regime

12.54 The CFIA experience demonstrated that this was a challenging but critical area.

12.55 Implementation team focussed on options for the human resource regime and on the transfer of staff.

These were the primary preoccupations of the human resources implementation team. Following consultations with all stakeholders and discussions with the Treasury Board Secretariat, OFIS recommended that the legislation establish the Agency as a separate employer under the *Public Service Staff Relations Act* and outside the staffing regime of the *Public Service Employment Act*.

12.56 The change to separate employer status and the move outside the staffing regime of the *Public Service Employment Act* were new territory for many involved in the creation of the Agency. The operational implications of this new status were not fully examined during the implementation phase; this was deliberately delayed until the first year of operations. As well, few members of the human resources implementation team or working groups became employees of the new Agency, which resulted in the loss of much of the corporate memory that had been developed during the implementation period.

12.57 The work and communication efforts of the human resources implementation team as well as those of the parent departments led to over 99 percent of employees accepting an offer of employment with the Agency.

12.58 Creating and implementing the Agency's human resource framework required time and resources.

In the Agency's first year of operations, a human resource strategy was developed in consultation with employees to support the CFIA business plan. The strategy outlined the key challenges facing the Agency in the next three to five years and was supported by a detailed work plan. As well, the strategy included a comprehensive set of values that governs the management of people in the Agency. These values serve as the foundation for human resource decisions, given that the Agency moved outside the *Public Service Employment Act*.

12.59 Once established, the Agency recognized the time and resources required to establish its human resource framework as a separate employer, and the full complexity of the task. This resulted in a number of challenges, including the following:

- Mobility for CFIA staff within the public service was a concern. To facilitate mobility, the Agency established memoranda of understanding (MOU) with the parent departments for the inclusion of CFIA staff among those they consider when staffing positions. We note that closed competitions under the Public Service Commission's staffing regime are potentially open to all persons in the federal public service, including the Agency. Access to specific competitions in departments is determined by deputy heads, who have been delegated the Commission's authority to establish areas of selection in accordance with the Commission's policy and the terms under which the authority was delegated.
- When the Agency started operations, its Labour Relations unit was largely vacant until a Director was hired to head the unit in the fall of 1997. The Agency was faced with numerous tasks, including responding to notices to bargain with existing bargaining agents. Over the past year, the Agency worked with unions to define a new bargaining structure that reduced the number of bargaining units from 27 to 4, and also made significant progress in negotiating new collective agreements.
- The CFIA decided in March 1998 to adopt the Universal Classification System developed by the Treasury Board Secretariat. The Agency planned to modify the Secretariat's system to suit the Agency's requirements. The full roll-out of this classification system can be expected to be a lengthy and challenging process, but it may facilitate the integration of inspection functions from the three departments.

Practice to Consider: Recognize early on that establishing a new human resource management framework as a separate employer is a complex task. A new framework requires time and resources to design and implement.

Early implementation of the accountability framework

12.60 The accountability framework is still to be tested. We reviewed the accountability framework set out in the Act and related documents.

- **Roles and responsibilities are set out.** The sorting out of roles and responsibilities was a key concern of the accountability implementation team. The team developed an accountability matrix that identified activities involved in the federal food inspection system. In addition, it identified any overlap and duplication of inspection services among the contributing departments. In this way, the team and the parent departments arrived at a common understanding of future roles and responsibilities of the key players.

In the area of food safety, the Act assigns roles and responsibilities to the ministers of both Health and Agriculture. The Minister of Health is responsible for establishing policies and standards related to the safety and nutritional quality of food. The Minister of Agriculture, through the Agency, is responsible for implementing those policies and standards; this includes the provision of all federal food inspection activities. The Minister of Health is responsible for assessing the effectiveness of the Agency's activities that relate to food safety. Thus, the legislation provided a check and balance for shared responsibilities in this complex area.

The legislation does not describe roles and responsibilities further. However, in one particular case, a memorandum of understanding between Health Canada and the Agency has been signed to outline roles and responsibilities and establish a working relationship in the area of food safety emergencies and related activities. In this way, the Agency and Health Canada have established a mechanism for clarification of roles and responsibilities. It is understood that roles and responsibilities will be reviewed further as the accountability framework continues to be used.

The Act gives the President of the Agency the authority to delegate power to "any person". This means that enforcement powers under the Act can be delegated to third parties, thus expanding the range of accountability. However, the Agency remains accountable to the Minister of Agriculture and ultimately to Parliament for the exercise of this power.

The clarity and effectiveness of these arrangements in the accountability framework still need to be tested as new events occur over time.

Useful Practice: Before establishing a new ASD arrangement, identify as clearly as possible the roles and responsibilities of the key players, especially in the areas of shared responsibility.

- **Review and adjustment mechanisms being developed.** The legislation does not provide any formal review mechanisms to settle disagreements that might arise in matters of shared responsibilities. It is up to the Agency and Health Canada to establish policies and protocols as needed to ensure co-ordination of their shared responsibilities. Some steps in this regard have been taken, as described above. In the area of food safety and recall, the Agency and Health Canada have a shared responsibility. They have signed a memorandum of understanding that provides for an annual review, the first of which resulted in a planned amendment to clarify procedures for the investigation and recall of food-borne matters that potentially can cause illness.

Practice to Consider: For new ASD arrangements that involve shared roles and responsibilities, establish specific procedures to resolve disputes and disagreements that may arise among the parties.

- **Performance expectations not yet known after one year.** In stating the government's objectives for the Agency, the Act provides only overall direction. The Agency's objectives, strategies and expected performance over that period are presented in its corporate business plan.

The corporate business plan was tabled one year after the creation of the Agency, in May 1998. It was based on extensive consultation, and reflects the needs of managers, clients and stakeholders. While the Agency's expected outcomes listed in the plan are results-oriented, they are not sufficiently concrete or precise to provide a good indication of what is to be achieved.

- **Balancing expectations and capacities.** It is perhaps too early to know if the transfer of assets from the three departments has achieved the right balance between resources and expectations. Concerns may yet be raised, for example, as to whether the transfer has left the Agency and the contributing departments with the appropriate resources to fulfil their respective mandates.

- **A credible reporting regime.** The reporting regime of corporate business plans and annual reports established in the legislation is sound. It has been strengthened by the Auditor General's role in providing an opinion on the Agency's financial statements and in assessing the performance information reported against the Agency's objectives. Although the Agency has been slow to develop its first annual report, due in the fall of 1998, it is beginning to implement a new results-based management framework. When implemented, this framework should provide a solid basis for reporting performance.

Role of central government agencies in the creation of the new Agency

12.61 A number of central players were involved in the creation of the CFIA. The Privy Council Office was involved in decisions on the structure, organization and ministerial responsibility and accountability for the Agency. In addition, the Privy Council Office was, in the CFIA's policy context, concerned with policy and administrative issues related to intergovernmental relations, government renewal and strategic national priorities. Similarly, the Treasury Board Secretariat, acting on behalf of the Treasury Board, provided advice on good public management from a whole-of-government view, and in particular on agency-specific concerns in the areas of financial and human resource management. The Department of Justice supported this initiative by playing its key role of providing legal advice and legislative drafting services. The Public Service Commission was consulted with respect to staffing issues that were expected to arise in the transition from departmental status to agency status.

12.62 Although there was no established blueprint for such an initiative, as is in keeping with the case-by-case approach adopted by the government, we would nevertheless expect that the central agencies would provide adequate and consistent guidance based on previous experiences with ASD-type initiatives.

12.63 Legal creation of the Agency. In order to meet the government's deadline for tabling, the legislation had to be drafted by September 1996, six months after the Budget announcement to establish the Agency. It was during this period that the role of central agencies became critical to ensuring that the commitment to the schedule was met and that sufficient resources were available for the drafting process and related matters.

12.64 For an intense six-week period, drafters from the Department of Justice worked to produce a draft of the Act. Individually, few components of the Act constituted a radical departure from the norm; but the whole was sufficiently different and complex that it required more work than a typical piece of legislation. Legal advice and legislative drafting services were co-ordinated by Justice in the areas of human resources law, expenditure management, and Crown law, among others.

12.65 Clear direction needed from central players. The establishment of new alternative service agencies was new territory for both the Treasury Board Secretariat and OFIS. At the same time that OFIS was seeking advice, the Secretariat was developing its own capacity to support the move to new alternative service delivery arrangements in a number of its policy centres. The Secretariat has informed us that it provided a wide range of support for the creation of the Agency. However, OFIS has told us that it did not always obtain clear and consistent advice and direction, particularly in the areas of human resource management and reporting requirements.

12.66 In light of the trend toward establishing ASD arrangements, and given the CFIA experience, the Treasury Board Secretariat conducted an internal study to analyze the role played by the central agencies and identify lessons learned for the launching of future government initiatives in alternative service delivery. One of the lessons identified was the need for a central agency presence and for individuals within the central agencies to visibly support the move to a new organization. The Secretariat has understood this need and has taken steps to ensure that it provides strategic and consistent advice to teams implementing new ASD proposals. In our view, that study was a positive step to identify key lessons from the CFIA experience that could be used in preparing for other government ASD arrangements.

12.67 The Public Service Commission is responsible for the application of the merit principle through the administration of the *Public Service Employment Act*. It had limited involvement in the creation of the Agency. As a separate employer that has authority to appoint its own staff, the Agency becomes solely responsible for maintaining core public service values.

12.68 With respect to the provision of legal advice by lawyers from Justice, there appears to be some uncertainty about how to best serve the needs of an emerging entity. The departments and central agencies involved in the creation of the Agency each had Justice lawyers ensuring the representation of their interests. However, several participants we interviewed pointed to the absence of similar legal representation to look out for the interests of the future agency.

Practice to Consider: Make it standard practice, given the government's case-by-case approach to establishing ASD arrangements, to bring together and provide the best advice possible to new agencies being set up, and make sure that the lessons learned in each case are well documented and communicated.

First Year of Operations

12.69 We have discussed the establishment of the CFIA, which occurred over the 13 months from March 1996 to March 1997. For the subsequent 12-month period, that is, between 1 April 1997 and 1 April 1998, the focus of our study was on the progress made by the Agency toward establishing its organizational structure, maintaining inspection systems and practices, and developing financial systems.

12.70 Ongoing development of the Agency. There are numerous approaches to establishing a new organizational structure. It can be done early, as soon as the new organization has been formed; or, as in the case of the CFIA, it can be done in a more incremental manner. In both cases, a certain amount of anxiety will be created.

12.71 During the first year of operations, staff were uncertain about their future roles and responsibilities and concerned about their employment status once their two-year job guarantee expires on 1 July 1999.

12.72 In April 1998, based on the recommendations of management working groups, the Executive Committee announced a new organizational structure that realigned functions at all levels of the Agency. The development of the Agency's organizational structure had been a lengthy process because the creation of the Agency was not only a consolidation of inspection services from three government departments. It also involved the creation of an organizational structure that would support the management of the transition to a number of new approaches. These included separate employer status; financial systems and practices in accordance with generally accepted accounting principles; performance reporting; and finally, a risk-based approach to food inspections. The challenge was to embrace all of this in an organizational and management structure, while ensuring the continuity of the inspection program. Nevertheless, there was a significant amount of frustration among staff who were expecting more and faster change.

12.73 Throughout the establishment of the CFIA, inspection operations generally remained unchanged; inspection systems and procedures used before April 1997 were largely maintained during the first year. The Agency ensured that trade with international partners continued without interruption. Important industry-related changes that had been occurring before the Agency's creation continued to be implemented. Now the Agency is also moving ahead with its commitment to work toward an integrated system of food inspection based on the harmonization of standards with provincial, territorial and municipal governments.

12.74 Financial systems and practices being developed. Before 1 April 1997, there was no formal analysis of what would be required of the Agency's financial systems at the start of business. The Agency started operations with few resources in its financial function and without its own financial systems and practices. During the first year of business, most of the financial staff came from Agriculture. The Agency had signed memoranda of understanding with the three parent departments for financial, informatics and/or administrative services. It had also opted to share a number of services with Agriculture and Agri-Food Canada through memoranda of understanding. This was a deliberate decision intended to cause minimal disruption and avoid duplication of existing systems and practices.

12.75 The Agency has taken an incremental approach to preparing its financial statements in accordance with generally accepted accounting principles (GAAP). It has been working on developing its financial reporting systems to reflect its operational requirements, and on making certain that appropriate financial and management systems are in place before the shift is made. In its recently issued corporate business plan, the Agency stated its intention to move to full accrual accounting for 1999-2000. This will be important to:

- provide users of the statements with a complete report of the Agency's operating costs, its resources and its obligations;
- present the results of its operations in a manner that matches outputs to the resources used to achieve those results; and
- facilitate improved financial management and controls.

12.76 There were consequences of adopting an incremental approach. On the positive side, operational managers continued to receive financial reports in the format to which they were accustomed and financial staff were able to use familiar systems and practices. This contributed to minimizing unnecessary disruption and to maintaining a more consistent control environment. It also minimized the number of overall changes occurring throughout the Agency during the first year of operations.

12.77 However, this approach limited the extent to which significant advancements in financial management and reporting could be made in the Agency's first year of operations; for example, its first financial statements will not include a balance sheet showing its assets or its liabilities. The Agency also continued to have difficulty providing data to support its user fee charges that would meet industry's expectations. Further, with the delay in finalizing an Agency financial function, there was some apprehension among regional financial staff about their future within the Agency.

Practice to Consider: Early establishment of a well-defined financial function increases a new agency's capability to manage its new financial flexibilities from the outset of operations.

Conclusion

12.78 Our study focussed on two stages: the successful creation of the Agency with the passage of the enabling legislation; and its first year of operations. The first stage of the reorganization was completed in a compressed time

frame. Early in the process, senior government officials established a timetable. The implementation team, senior departmental officials and the central agencies maintained momentum for change. The legislation was passed on schedule, 13 months after the Budget announcement. The support and dedicated resources ensured the successful creation of the Agency.

12.79 The CFIA faced a number of challenges in setting up its management framework to operate as a new service agency. It has had to consolidate programs from three departments and work on the configuration of a new organizational structure; it has been co-operating with Health Canada and with other levels of government to streamline inspection programs nationally; it has been developing its own identity and culture as an agency. The Agency has also worked to meet the expectation that it would be more innovative, flexible and efficient in the delivery of services. The Agency has had to do this under pressures of time and, more significantly, while ensuring the continuity of food safety and quarantine programs.

12.80 Many demands lie ahead. The Agency has the legislative authority to operate with greater autonomy and flexibility. The real challenge is to use this new flexibility to meet the government's commitment to a new and better way of delivering services. The concern is that the longer the Agency takes to create systems and practices that reflect its powers, the more it risks falling back into traditional ways of doing business.

About the Study

Scope

We focussed our study on two periods of time: the implementation period starting with the Budget announcement to create the Agency, March 1996, until the passage of the enabling legislation, March 1997; and the first year of operations, April 1997 to April 1998. We reviewed key factors and challenges during the implementation period. In addition, we examined the first year of operations in relation to the Agency's organizational structure and systems and practices. This was a case study of one government transformation of services to an ASD agency.

Objective

The objectives of this study were to:

- describe the reorganization of the federal food inspection system;
- describe the Agency's progress during its first year of operations; and
- identify practices to consider in ASD arrangements.

The study did not include an assessment of the Agency's performance. Rather, it was a case study of a move to a legislated service agency. Although we identified a number of sound practices in this particular case, their applicability to other ASD arrangements would depend on the circumstances.

Approach

Our findings and conclusions were based on extensive interviews with the players involved in the Agency's implementation period and its first year as an agency. We reviewed available written materials on the experience and made numerous site visits.

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Chapter 13

National Energy Board

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National Energy Board

Main Points

13.1 The *National Energy Board Act* has not been amended significantly since it established the National Energy Board (NEB) in 1959. While the NEB has been given some new responsibilities in areas such as frontier activities, its role has not changed much since its creation. However, its modus operandi has changed significantly. Through regulatory changes, the Board has moved from an interventionist approach to reliance on market-based forces, industry self-regulation and negotiated toll structures. During this period of evolution, the NEB has moved its operations from Ottawa to Calgary, downsized its staff complement by 35 percent and reorganized itself internally for greater efficiency. However, it has not objectively measured the extent to which it is being effective and relevant.

13.2 The Board has recognized that the aging of the Canadian pipeline system poses potential threats to public safety and the environment. The number of reported pipeline incidents has increased in recent years. A risk assessment methodology is being developed that should improve the targeting of inspections and safety audits. However, deficiencies in information management will need to be addressed.

13.3 The Board's ability to fully meet its environmental regulatory responsibilities is at risk due to shortfalls in its environmental inspection program — namely, in setting priorities and scheduling inspections and in inspection practices, which are too informal and unstructured.

13.4 Since 1991, the NEB has recovered most of its costs from industry. No change has yet been made to its cost allocation method, despite some concerns expressed by stakeholders about its fairness. The NEB has settled for simplicity at the expense of cost causality. The Board does not have a cost accounting system; it needs to recover costs in a way that is more equitable and acceptable to stakeholders.

13.5 The NEB is moving toward management for results, by adopting a new accountability framework and changing its style of decision making. While it is too early to evaluate the results of this initiative, we noted that significant opportunities exist to better link its human resource management activities to its vision of the future. In addition, the NEB will need to state and report clearly what it wants to achieve, monitor its performance on a regular and systematic basis and better link the results achieved to the costs.

Introduction

What Is the National Energy Board?

13.6 The National Energy Board (NEB or the Board) is an independent regulatory tribunal reporting to Parliament through the Minister of Natural Resources. Its main responsibilities (Exhibit 13.1) are defined in the *National Energy Board Act* and the *Canada Oil and Gas Operations Act*. Most of the Board's activities deal with international and interprovincial oil and gas pipelines and exports. It has few activities dealing with the electrical sector, and staffing in that area has been reduced to four people.

Exhibit 13.1 is not available, see the Report.

13.7 The NEB's corporate purpose is to make energy-related regulatory decisions that are fair, objective and respected. The Board promotes:

- reasonable transportation costs and fair access to shippers, and fair return on investment;
- the functioning of the energy market without disruption;
- fair market access by Canadians to energy proposed for export; and
- safety and environmental protection.

13.8 The NEB expenditures for 1997-98 were \$28 million, of which about 90 percent is recoverable from regulated companies. It has a staff complement of 277.

Evolution of the National Energy Board

13.9 The NEB was formed when government regulation had more public acceptance, at least for the oil and gas industry, than it appears to have now. The past decade has seen a major shift by government from detailed intervention by means of regulation toward a more market-based process of economic decision making. The NEB is changing its modus operandi in light of these shifts in societal perspectives on regulation, and has modified its processes and internal management structure correspondingly.

13.10 Moving from a strictly regulatory process to one more broadly influenced by a market-driven economy has seen the NEB start to play a less significant role in some areas. Although it still regulates various companies in the pipeline and electrical sectors, the degree of regulation has changed. It no longer micromanages the regulatory process, and many of the functions previously carried out have been reduced or ended.

13.11 The NEB has adapted its regulations and processes to the changing energy market and to resource constraints (Exhibit 13.2). For example, in the last 10 years it has changed its processes for toll approval, financial surveillance and assessing long-term gas export licences. Even though the NEB processes have changed, the *NEB Act* has not been amended fundamentally since the Board was created in 1959. Oil and gas commodities are still transported by a few pipeline systems holding dominant market positions, and therefore may require some regulation.

Exhibit 13.2

Key Historical Dates for the National Energy Board

1959	Establishment of the NEB.
1970	Proclamation of the licensing provisions for exports.
1973	The Board recommended oil export controls
1974	Export tax converted to export charge and collection was delegated to NEB.
1975	<i>Petroleum Administration Act</i> passed by Parliament, giving Cabinet the power to regulate oil and gas prices.
1980	Announcement of the National Energy Policy.
1981	Amendment to the <i>NEB Act</i> to establish new procedures for determining the route of a pipeline and acquisition of the right-of-way, and to deal with compensation and damage claims resulting from the construction of a pipeline.
1982	Amendment to the <i>NEB Act</i> that broadened the Board's authority to permit expropriation for international and interprovincial electric power lines. Adoption by the Board of a change in procedure to take into account actual instead of authorized level in determining the amount of surplus natural gas in Canada available for export.
1983	Amendments to the <i>NEB Act</i> that provided new measures to protect the rights of landowners.
1984	Demise of the National Energy Policy.
1985	Deregulation of oil and gas. Agreement between the federal government and the three western gas-producing provinces allowing gas buyers to contract for supplies with producers, marketers and other agents at freely negotiated prices. End of export charge.
1986	A new surplus determination procedure, based on maintaining a ratio of 15 years between reserves and total annual production, was adopted by the Board to determine the surplus of natural gas in Canada available for export. The Board decided to classify oil and gas pipelines in two groups, aimed at reducing the need for financial regulation. Tolls of smaller companies (Group 2) are to be reviewed only on receipt of a complaint.
1987	Adoption of new procedures called the market-based procedures for determining the surplus of natural gas available for export.
1988	<i>NEB Act</i> amended to take into account the Canada-U.S. Free Trade Agreement. New electricity export policy announced by EMR Minister, which reduced regulatory requirements for exporting electricity and for international power lines.
1990	The Board changed its Market-Based Gas Export Procedures to no longer include social benefit-cost. <i>NEB Act</i> amended to give effect to the government's electricity export policy and to recover the cost of its operation from the industries it regulates. Creation of the Transportation Safety Board, which is given priority over NEB to investigate incidents related to the operation of a pipeline.
1991	The government announced the transfer of responsibility for the oil and gas regulation in the North (Frontier) to the NEB. The Board moved from Ottawa to Calgary.
1992	NEB was granted Separate Employer Status.

1995	<p><i>Canadian Environmental Assessment Act</i> took effect and NEB is deemed to be a “responsible authority”.</p> <p>Established the cost of capital for major pipelines on a generic basis and provided for automatic annual adjustment of the rate of return on equity.</p> <p>NEB approved the first negotiated settlement between a pipeline company and its shippers, reflecting an incentive–toll methodology and associated tolls and tariffs.</p>
1997	Internal reorganization from 10 branches to five business units.

13.12 Up to 1985, long–term gas exports were approved under section 118 of the *NEB Act* only after the NEB was satisfied that Canada would still have a strategic reserve. Since price deregulation in 1985, procedures for assessing long–term gas export licences have changed three times. In particular, the *NEB Act* was amended in 1988 to reflect the Canada–U.S. Free Trade Agreement (FTA). The FTA made it more difficult for the Board to intervene in the free flow of energy commodities across the Canada–U.S. border. Now the NEB approves export licences provided that Canadians have access to the oil and gas at competitive prices. In 1997, sales under export licences, typically lasting for 10 years, represented about 35 percent of total export gas sales compared with 78 percent in 1987. The balance of 65 percent represents exports under short–term orders, which apply for a period of up to two years and are renewed automatically upon request.

New challenges

13.13 The oil and gas industry is highly active at present, with commensurate impacts on the NEB’s workload. The proposed construction of new pipelines in the next few years raises the likelihood of increased competition among companies, which might move the Board into an arbitration role and could result in further changes to regulatory approaches.

13.14 In the 1998-99 Report on Plans and Priorities, the Acting Chairman noted that the energy industry is at a dynamic stage and its relationship to environmental and safety considerations is evolving. The recent burst of industry activity has resulted in increased workload for the NEB and, at the same time, has produced job market conditions that make it very difficult for the NEB to attract and retain qualified staff.

Focus of the Audit

13.15 The Board operates in a quasi–judicial manner. Its decisions and the evidence presented are all on the public record. Therefore, we did not examine the hearing or evidentiary processes. Instead, we looked to see what strategic challenges face the Board and we concentrated our audit effort on them, including important management processes and key operational aspects. More details are included in **About the Audit** at the end of the chapter.

13.16 During our work, we consulted extensively with the pipeline industry and various associations, both in person and through a telephone questionnaire.

Observations and Recommendations

Reorganization to Focus on Results

13.17 During the last 10 years, the NEB has changed significantly, with reductions in staff by 35 percent to about 277, a move to Calgary in 1991, and an internal reorganization in 1997.

13.18 The reorganization was aimed at increasing operational effectiveness. The internal structure changed from 10 functionally structured branches (for example, engineering) to five results–focussed business units: Applications, Operations, Commodities, Information Management and Corporate Services. Each of these units is headed by a business leader. Collectively, the business leaders, along with the Executive Director, constitute the Executive team, which is accountable to the Chairman of the Board. We discuss in paragraphs 13.83 to 13.97 the challenges the NEB faces as it moves toward managing for results.

13.19 It is too early to evaluate the results of this change. We understand that the NEB is planning to conduct a survey in the near future to get feedback from its staff. We encourage it to do so and to monitor and report the results to the Board.

The Trend Toward Negotiated Tolls

13.20 Historically, tolls on major pipelines were set through a cost–of–service methodology that required detailed analysis and approval processes. Recently, a growing number of tolls in the larger companies have been products of negotiated settlements between shippers and pipelines that reflect the business risks and appropriate financial returns or shared cost–saving incentives. For other pipelines, usually smaller ones, tolls are approved subject to the filing of a complaint. In essence, the operational approach to ensuring that tolls and tariffs are just and reasonable has been altered over the years.

13.21 The results expected from the move to negotiated incentive settlements are lower transportation costs and a reduced regulatory burden. Since the introduction of negotiated settlements, the NEB has exempted companies from having to provide information on their financial and operational performance pursuant to Toll Information Regulations. To protect the public interest, however, it does need to monitor the effectiveness of its new processes.

Operations in Support of the Regulatory Process

13.22 As the Board considers applications made by pipeline companies, its staff provides analytical support to the approval process. Two elements, safety and the environment, are given particular emphasis under federal legislation. These elements extend beyond the approval itself, into pipeline construction, operation and ultimately abandonment when the pipeline is no longer useful. The Board may impose specific conditions in its approval, and the *NEB Act* sets out severe penalties if these are not complied with.

13.23 We examined how the NEB manages its safety and environmental responsibilities under the applicable legislation. Major responsibility for these functions is vested in the Operations Business Unit, with the Health, Safety and Environment and the Pipeline Integrity teams. These teams employ specialists, including engineers and environmental scientists, and have a total staff of about 20.

13.24 Given the resources it has available, the Board has chosen an approach for its regulatory regime that relies in part on co–operation with the industry. In the light of that approach, we expected to find that the NEB had adopted a risk–based approach to its inspection and monitoring processes, based on good information. The extent to which it has done so is described below.

Safety and environmental regulatory responsibilities

13.25 Pipelines transport oil, natural gas and other commodities over great distances and ensure a reliable supply for residential, commercial and industrial consumers. Even though the number of accidents with pipelines is extremely low compared with other modes of transport, the construction and operation of pipelines is not without

risks. The NEB tries to ensure that such risks are properly identified, managed and minimized. Exhibit 13.3 provides details on how it regulates safety and environmental matters.

Exhibit 13.3

How NEB Carries Out Its Safety and Environmental Responsibilities

Critical Steps in Pipeline Cycle	NEB Safety and Environment Responsibilities
Design	<ul style="list-style-type: none"> - Develops and maintains regulations - Develops guidelines related to filing requirements - Assesses applications to ensure that they meet safety requirements and environmental - Establishes terms and conditions for approval
Construct	<ul style="list-style-type: none"> - Conducts construction inspections - Monitors and enforces terms and conditions - Follows up post–construction reports
Operate	<ul style="list-style-type: none"> - Conducts regular on–site inspections - Conducts pipeline crossing audits and inspections - Conducts documentation and safety audits at company office - Follows up landowner concerns - Records accidents/incidents - Investigates significant accidents¹ - Monitors companies’ responses
Abandon	<ul style="list-style-type: none"> - Assesses whether there are any adverse environmental effects and what restoration work is required

¹ Shared jurisdiction with the Transportation Safety Board.

13.26 Pipeline companies have the primary responsibility for environmental compliance and operational safety of the pipelines. The existence of laws, and the threat of lawsuits by injured parties along with the associated potential loss of revenues, provide strong incentives for owners to comply with the rules. But the NEB also has an important responsibility for ensuring that owners comply with the applicable laws. It accomplishes this through making regulations, assessing applications, imposing specific conditions, conducting inspections and audits and investigating incidents.

The risks of aging pipelines

13.27 Public concerns over safety and the environment have increased as pipelines have aged. About 60 percent of the present 40,000 km of pipeline regulated by the Board was constructed more than 20 years ago (Exhibit 13.4). Safety and environmental issues include potential injury or death of pipeline company employees or members of the public, degradation to the environment, and damage to public and private property.

Exhibit 13.4 is not available, see the Report.

13.28 Pipeline age alone may not be the sole determinant of risk; construction practices, methods and materials, along with maintenance practices, also play a part. Nonetheless, older pipelines are receiving more attention.

13.29 The NEB has recognized pipeline integrity as an emerging risk area, but has not analyzed its regulated pipelines by age or location. At present the Board keeps a separate paper file on each reported incident. It records basic information including the date, company name, location, a short description of the incident, the category or type of incident, the consequences, and the action taken by the company. The NEB has an electronic data base, but it has not been updated since February 1997 and is of limited use in determining trends and identifying risk areas. For example, data showing the relationship between pipeline ruptures and aging could not be retrieved because they are

not collected that way. The NEB notes that it has been working for the past year with industry to collect more comprehensive data to support risk management. Because this initiative is not complete, the NEB does not know whether it will be satisfied with the results and may yet have to develop its own system.

13.30 The NEB has a limited number of human resources to carry out its safety and inspection activities. Thus, it must be able to work co-operatively with other regulators or agencies and pipeline owners to discharge its regulatory responsibilities adequately.

Pipeline incidents follow-up

13.31 Reported pipeline incidents per thousand kilometres of regulated pipeline have increased by 73 percent in the last five years (Exhibit 13.5). The most prevalent types of incidents are uncontrolled spillage, usually of liquid oil product, and uncontrolled escape of natural gas and high-vapor-pressure products. Since 1992, significant ruptures have totalled 18, with a high of 6 in 1994.

Exhibit 13.5

Pipeline Incidents per Thousand Kilometers of Regulated Pipeline

	1992	1997
Incidents reported ¹	48	88
Approximation of thousands of kilometers of regulated pipeline ¹	37,800	40,000
Incidents per 1000 km	1.27	2.2

¹ Source: NEB Annual Reports

13.32 Section 60 of the Onshore Pipeline Regulations requires pipeline companies to report to the NEB any incident involving the construction or operation of a pipeline that results in a fatality or injury requiring hospitalization, a fire or explosion, an oil spill, a pipeline rupture, or any other failure or malfunction of the pipeline. The NEB reviews all reported incidents. For major incidents involving serious injury or the release of large volumes of oil or natural gas, it conducts detailed on-site investigations. It then produces a report containing its findings and recommendations aimed at preventing future similar incidents.

13.33 We examined four incidents investigated by the NEB to see whether reasonable corrective measures had been taken as a result of its recommendations. While we found evidence of follow-up on these recommendations, we noted that the NEB does not have a tracking system to provide assurance that all recommendations are followed up and that corrective measures taken are documented.

13.34 The National Energy Board should:

- **increase its capacity to analyze pipeline incidents by improving its data base, including the sharing of data with other jurisdictions and other regulators; and**
- **improve its management of information to ensure that recommendations arising from pipeline investigations are systematically followed up and that corrective measures taken are documented.**

Board's response: *The Board accepts the recommendation and will implement an internal data base for the tracking of recommendations by 30 September 1998. The NEB will develop an action plan by 30 October 1998 to improve its data base for pipeline incidents with a longer-term goal of having a data base to be shared with other jurisdictions in place by December 1999. We will build on existing initiatives to ensure that the Board's needs and those of other regulatory agencies and the industry are met.*

Safety and environmental interfaces with other jurisdictions

13.35 The Board has identified many areas where it could work effectively with other organizations. It has attempted, where practical, to reduce regulatory overlap and provide more efficient regulatory services.

13.36 The Board in the past has assumed a mandate for environmental protection as a component of the public interest under the *NEB Act*. Since 1995, the *Canadian Environmental Assessment Act* requires that all projects that can impact the environment undergo appropriate levels of assessment before they are approved. The Board, as a "responsible authority" under the *CEA Act*, ensures that such environmental assessments are conducted for projects under its jurisdiction, taking into account the factors set out by that legislation. Arrangements are being made between the NEB and the Canadian Environmental Assessment Agency to harmonize their quasi-judicial and administrative processes.

13.37 Shared jurisdiction. There is also a matter of shared jurisdiction: since 1990, operating pipeline incidents must also be reported to the Transportation Safety Board. Parliament has mandated both the NEB and the Transportation Safety Board to investigate essentially the same things.

13.38 While the NEB can investigate incidents, it cannot, under section 14(3) of *The Canadian Transportation Accident Investigation and Safety Board Act*, conclude about their causes and contributing factors where the Transportation Safety Board also investigates. From 1991 to 1997, the Transportation Safety Board has investigated 24 operating pipeline incidents. We question whether it makes sense for pipeline companies to report incidents to two entities with similar jurisdictions and for both of them to investigate.

13.39 Two separate studies have examined this sharing of jurisdiction. On one hand, the 1994 Report of the Canadian Transportation Investigation and Safety Board Act Review Commission held that jurisdiction should be retained by the Transportation Safety Board, because of a potential for conflict between regulators and those in charge of accident investigations. It recommended that the NEB's jurisdiction be restricted to investigating accidents involving new or rebuilt pipeline construction. On the other hand, a Regulatory Review Report 1992-1994, published by the Treasury Board Secretariat, noted that a Minister's Advisory Panel had endorsed an NEB recommendation to delete pipelines from the mandate of the Transportation Safety Board. No changes have yet been made to either Act to reflect the concerns raised.

13.40 Since 1994, the two agencies have had a memorandum of understanding setting out a protocol for co-ordinating their respective investigations of operating pipeline incidents. However, this does not address the broader issue of shared jurisdiction. We were advised that the two entities are examining ways of harmonizing their reporting criteria as well as the possibility of having incidents reported to only one of them.

Need to improve information management and ensure compliance with Board approvals

13.41 When the Board approves pipeline construction, it may include terms and conditions to which applicants must adhere in addition to the applicable legislation and approved specifications and procedures. In cases of non-compliance, the Board is empowered to impose a penalty of up to \$1 million and/or jail terms. The Board uses a graduated approach to resolving any non-compliance. First, it requests the company to provide its Assurance of Voluntary Compliance; second, it issues a Board Order compelling the company to rectify the situation if no Assurance of Voluntary Compliance is received; and third, it imposes a penalty. As a result of this graduated

approach, no penalty has ever been imposed. A system of penalties for repeated or persistent non-compliance was to be developed in 1997-98, but this was not done.

13.42 Since the *Canadian Environmental Assessment Act* was enacted, the number of environmental conditions attached to the issuance of pipeline certificates has increased and is generally in the range of 15 to 30 per certificate. The Board has started to establish tracking systems on large projects to ensure compliance with the conditions. In 1996, for example, it created a Project Working Group to ensure compliance with Board conditions and to oversee the inspection program of a major pipeline project. However, because the NEB does not keep track of conditions for all Board approvals, it cannot provide assurance that they have been properly followed up.

13.43 Compliance with terms and conditions of regulatory approvals was identified as one of the 1998-99 performance measures for the Operations Business Unit. We believe that the NEB needs to have data to be able to provide assurance to the Board that all conditions attached to its approvals have been properly monitored for compliance, and to provide feedback on the effectiveness of the conditions.

13.44 The NEB has to work co-operatively with the pipeline industry to fulfil its regulatory responsibilities while preserving its independence. Under the Onshore Pipeline Regulations, pipeline operators generate useful environmental information through their own monitoring and surveillance programs. However, this requires direction from the NEB. Such direction has been the subject of a proposed guideline for the monitoring and surveillance program. The NEB has access to the data gathered by the pipeline operators. If verified regularly and combined with information collected under its inspection program, this could constitute an environmental data base or historical record both for reporting performance and for evaluating the Board's environmental decisions. But this would require a more comprehensive environmental information management system than is currently in place and an effective environmental audit program, which does not now exist.

13.45 The NEB lacks an effective information system necessary to support assessment of the cumulative effects of pipelines on the environment. It needs to collect such data not only for its own use but also for co-ordinating its work with other agencies, thereby ensuring that all available information is "on the table" to facilitate regional and local land-use planning and associated activities.

13.46 An effective environmental information system provides a basis for sound strategic and tactical planning, and a means of reporting the results achieved. It can also be used to identify and evaluate risks, and can help in determining the resources needed to meet legal responsibilities. It is therefore in the NEB's interest to have up-to-date information systems in order to be able to function efficiently and effectively. The NEB has recognized many of the shortcomings of its information management system with respect to environmental issues, but has not yet developed a specific action plan to rectify the situation.

13.47 The National Energy Board should:

- **determine its environmental information management needs and develop an appropriate system; and**
- **ensure that all requirements associated with Board approvals are monitored systematically for compliance and to see if they are accomplishing the desired results.**

Board's response: The Board accepts the recommendation and has expanded its existing compliance monitoring system to include all NEB approvals of facilities. Although the recommendation is specific to environmental information management needs, we believe there is a significant benefit in the integration of the environmental and safety auditing programs. We will develop by 30 October 1998 an action plan for the complete review of our environmental and safety information needs and an action plan for the development of an appropriate information management system.

Need to implement a rigorous safety and environmental risk management framework

13.48 Given the NEB's resources, an important question is how much monitoring is enough to fulfil regulatory requirements? Although some external checks and balances on pipeline companies are provided in law and by various watchdogs and vested interests, the NEB has to strike a balance between the need to assess the inherent risks of a pipeline throughout its life cycle and the effective use of the limited resources available for inspection and audit. Risk management provides a framework for making such determinations. We expected that the Board would have a clear policy to provide direction for the cost-effective discharge of its safety and environmental monitoring responsibilities using risk management techniques, and that the work would be planned and resources allocated accordingly.

13.49 The Board's information bulletin on safety audits indicates that they are conducted every two years for large companies and every four years for other companies. Safety audits review procedures and records of these companies to verify compliance with regulations and to address any safety issues.

13.50 Safety audit based on subjective assessment. Due to resource constraints, 40 percent of scheduled safety audits were not carried out in 1997-98. Only companies with the highest safety risks had been selected for safety audit. However, we understand that the evaluation of safety risk was based on staff knowledge but that no rigorous risk analysis was conducted and the criteria were not validated. For example, data on recent incident trends were not used in selecting audits to be carried out. Based on current scheduling practices, 25 safety audits should have been carried out in 1997-98 but only 15 were conducted.

13.51 The need to develop risk assessment methodologies was identified as a strategy for 1997-98. This would provide for an audit focus on the companies and activities where the risk of non-compliance or other risks are high and where increased surveillance is thus required. However, the risk assessment methodologies have not yet been developed and are not expected to be completed until the second quarter of 1998-99.

13.52 Environmental inspection cycles not always followed. There is no clear policy on the scheduling of pipeline environmental inspections, but the current practice is to conduct periodic inspections: during pipeline construction, post-construction (that is, within three years following construction), and in three- to five-year cycles thereafter during the operational period. Inspections at the post-construction stage are to ensure that restoration measures have been put in place and are effective. This approach has evolved within the Health, Safety and Environment Team and is based on past experience and the availability of resources.

13.53 The NEB's pipeline inspection regulations require companies to file post-construction environmental reports identifying any issues that arose and indicating how they were resolved. Companies are also required to provide follow-up reports after the next two growth seasons. The NEB relies on the self-reporting of companies and inspects only a limited number of construction sites to verify the accuracy of the reports.

13.54 The NEB is developing a risk analysis approach toward scheduling and conducting environmental inspections. Recently, its inspection staff dropped from three to only one. Only inspections considered to be highest priority have been carried out. NEB staff informed us, for example, that last year they visited only 4 out of 28 potential sites as part of a post-construction inspection.

13.55 In our opinion, post-construction inspection is not being given the attention it deserves. The condition of the right-of-way after its restoration represents an environmental benchmark against which future changes could be measured and the effectiveness of Board decisions assessed. The Board needs to give this more emphasis in the inspection program.

13.56 Current environmental inspection practices are too informal. The NEB introduced two environmental inspection manuals in 1988-89, one for construction and the other for operations. However, the manuals are not used

routinely in inspections. Although there are generic lists of environmental concerns to be included in inspections, there are no detailed checklists or audit programs that inspectors are to complete during the various phases to ensure that all required aspects are covered systematically.

13.57 For three projects that we selected at random for review, NEB staff were unable to find the inspection binders, which are supposed to contain all relevant inspection documentation. Nor could they locate the inspection reports on two of the three projects. We were given various reasons for this, including the misplacement of inspection binders by staff not currently part of the team and improper filing due to the heavy workload. If workload was indeed a contributing factor, we expect the situation to deteriorate further as the number of applications continues to rise along with the number of kilometers of approved pipeline to be inspected.

13.58 The National Energy Board should:

- **use a rigorous risk assessment methodology to determine the level of safety and environmental inspections and audits needed to fulfil its legislative responsibilities, and allocate its resources accordingly; and**
- **formalize its environmental inspection procedures and strengthen its documentation practices.**

Board’s response: The Board accepts the recommendation and, as noted in the chapter, has under way a project to develop a risk assessment tool to assist in the allocation of resources to safety and environmental audits. The project will be completed by 30 November 1998. The NEB will review all of its environmental and safety audit procedures and ensure that they are complete and in place by 31 December 1998. Adherence to procedures will be an emphasis of management. The NEB will increase the resources allocated to its safety and environmental auditing program to replenish those resources lost through attrition or those resources diverted to handle the extremely high applications workload experienced in the past few years.

Human Resource Management

13.59 When the Board moved from Ottawa to Calgary in 1991, it had 310 employees. Only 130 relocated, with the option of returning to Ottawa. Eventually 25 of them did return.

13.60 More recently, in response to evolving markets and government policies, the NEB has reorganized from a conventional structure into a rational business grouping that emphasizes teamwork and is less hierarchical. The NEB is to be commended for its new approach to organizational structure, even though it is too early to judge the ultimate success of this initiative.

13.61 As the NEB started to fit into the Calgary environment and implement its new business structure, it considered whether it had the right mix of people to meet the new challenges. At the same time, the Board was conscious of the need to remain independent of the industry it regulates and to be objective in its dealings. In 1993, the Board introduced a Code of Conduct to guide its staff. Since its relocation to Calgary, the NEB’s human resource management processes have been undergoing revision (see Exhibit 13.6).

Exhibit 13.6

Key Changes to NEB Human Resource Management Processes since 1991

1992	<ul style="list-style-type: none"> • gained flexibility as a separate employer in order to compete in the Calgary market
1993	<ul style="list-style-type: none"> • implemented a new staff classification plan

1994	<ul style="list-style-type: none"> conducted an employee survey
1995	<ul style="list-style-type: none"> followed up on the survey with a vision implementation project
1997	<ul style="list-style-type: none"> adopted a new accountability framework effective April 1 and reorganized from 10 branches into 5 business units

High staff turnover

13.62 The NEB views the ability to attract, develop and retain highly skilled staff as one of the important elements in meeting its strategic objectives. The past two years have been especially challenging, partly due to increased activities in, and competition from, the energy market.

13.63 The NEB's operations are located in a highly competitive market, the Calgary oil patch. It is competing for talent with an industry that has greater salary flexibility, and that may offer staff more attractive career opportunities than a government agency.

13.64 Since relocating, the NEB has had to hire professional staff to fill vacancies. The NEB has had high staff turnover in the last two years, reaching 18 percent in 1997-98 (Exhibit 13.7); and chronic vacancies have resulted in extra workload on remaining employees. Total human resources have decreased in the last 10 years, but the NEB has always had fewer staff resources than it projected it would need. Elsewhere in this report, we note that the NEB has some operational deficiencies in implementing its safety and environmental mandates, which may be due to a lack of staff with appropriate experience.

Exhibit 13.7

National Energy Board Employee Activities

Fiscal Year	Employees Leaving	Turnover Rate %	Employees Hired
1994-95	40	13.4	18
1995-96	41	14.7	34
1996-97	29	10.7	20
1997-98	49	17.7	29
Total	159		101

Note: Includes retirements, death in service, end of term, transfer out/in, layoff and resignation.

13.65 Organizational change. With any radical change, some people are unhappy or unwilling to adapt and this can adversely affect morale and productivity. For example, an analysis of NEB exit interviews revealed that some people saw low pay as a disincentive; others did not like the particulars of the reorganization, even though they seemed to approve of the initiative itself; and others cited low morale. At the same time, some employees spoke positively about job satisfaction, the good working environment and generous training opportunities.

13.66 While exit interviews may present some bias, they can also give valuable information from which lessons can be learned. The NEB could confirm the validity of exit comments by seeking input from employees who have not left, for example, through its Classification Review and Leadership Training projects. Without a rigorous, documented analysis of the views of staff both leaving and remaining, it will be difficult for management to determine conclusively whether staff turnover is caused by factors such as remuneration or by other factors.

13.67 As staff resource levels have declined, partly by design and partly because of competition factors, the NEB has had to come to grips with a number of human resource challenges. It has undertaken about 20 human resource management projects since 1997. We believe that many of these projects could have been structured better if they had been linked to an overall human resource strategic plan, and if the NEB had set clear goals and objectives for each project.

Predicting future staffing needs is crucial for the NEB

13.68 The NEB has identified key factors that will influence its regulatory program over the next three years, but we have not seen any analysis of the levels and skills it will need in its staff and how it will attract them, considering its resources and staff turnover. Consequently, in spite of new human resource management initiatives, there is a risk that the NEB may be more reactive than proactive, and may lack appropriate resources in the future to deal with new issues. Management has identified a need to develop a human resource strategic planning framework, but at the time of our audit this project had not been started.

13.69 Management needs to build on its positive initiatives, create better communication to dispel any concerns resulting from the organizational changes, and introduce initiatives that can improve its effort to retain staff. The NEB recognizes this problem and has made some positive changes to try and compete for staff more effectively, given the government environment in which it functions. We noted, for example, the inclusion of some incentive measures in the recent collective agreement signed with its professionals.

13.70 **The National Energy Board should ensure that its human resource management activities are clearly linked to its vision of the future and that its related projects are carried out in accordance with a systematic plan and in response to its operational needs.**

Board's response: The Board accepts the recommendation. In the fall of 1998 the NEB will develop clearer context, strategies and expectations for performance. This will provide the environment within which human resource management activities can be more clearly linked to the NEB's vision of the future and enable the development of a systematic human resource strategic plan. A human resource strategic plan will be in place by 1 April 1999.

Cost Recovery: Who Pays?

13.71 Since 1991, the NEB has recovered most of its costs from the companies it regulates, except the costs related to its frontier activities. The regulations identify companies subject to cost recovery on the basis of their size. Small companies are charged an annual fee of \$500 and intermediate-size companies \$10,000. The remaining costs are charged to large companies based on staff time spent on the regulation of each commodity and according to their relative share of volumes shipped or, for electrical companies, volumes exported.

13.72 In 1995, a staff working group was established to consider the updating of the Cost Recovery Regulations. Some of its recommendations were reflected in the revised regulations, approved in April 1998. No amendment was made to the cost allocation method, except a minor revision to the calculation of electricity export volumes.

Are costs recovered equitably?

13.73 The cost allocation method has been the same since it was first introduced. It is based on direct time charged into three commodity pools: gas, oil and electricity. While this is simple to administer, it raises some concerns about fairness, one of the objectives pursued by the government cost recovery and charging policy. For example, we noted that:

- the portion of indirect time charged to commodities remains high, at about 60 percent;
- the NEB costs of processing applications and of hearings are not borne by the applicants but instead are recovered from the existing large companies, based on their respective volumes shipped. The net effect is that existing companies are paying for the cost of processing new applications, some of which may be those of competitors;
- only about 60 percent of direct staff time was spent on large companies in the last three years, whereas 99 percent of the costs are recovered from this group; and
- under the cost recovery regulations, the costs charged for a given year are based on time actually spent in the previous fiscal year, and are not adjusted to reflect current-year actuals.

13.74 Stakeholders have expressed dissatisfaction with the present cost allocation methodology. When it assessed the feasibility of cost recovery, the NEB conducted preliminary analyses of allocation methods. The present commodity allocation method was selected over using a detailed fee structure or charging direct time. One industry association commented in 1989 that the Board had settled for simplicity at the expense of cost causality in its decision to use the cost allocation method. The NEB set up a Cost Recovery Liaison Committee to provide a forum for stakeholders and staff to discuss cost recovery issues of mutual concern. Our review of the Committee's minutes indicated that some industry representatives have complained that the current allocation method does not share costs equitably among the regulated companies.

13.75 In our opinion, the method now used for cost recovery raises questions about equity. As more applications are pending and stakeholders raise concerns about fairness, there is a need to review the present cost allocation method.

13.76 There is no cost accounting system. The NEB uses its Time Reporting System to identify the time spent on regulating each commodity, and costs are allocated based on time spent. The NEB does not have a cost accounting system. It is important to know how much it costs to carry out a specific activity, not only for cost recovery but also for management purposes. If data from the Time Reporting System could be merged with data in the current financial system, this might provide an adequate basis for costing.

13.77 Cost control versus operational efficiency. As a government agency, the NEB has been subject to the same budgetary reductions as other departments. Yet the NEB's costs, for the most part, are paid by industry and not from the public purse. Given its growing workload, and the needs of stakeholders for thorough and timely decisions, there may be an opportunity for the Board to discuss a more flexible financial arrangement with the Treasury Board and its other stakeholders to better match its resources with its service needs.

13.78 The National Energy Board should:

- **recover its future costs in a more equitable and acceptable manner, to be developed in consultation with the regulated industry; and**
- **develop a cost accounting system so it can identify the costs of processing applications and of other activities, for cost recovery and management purposes.**

Board's response: The Board accepts the recommendations, and has already started negotiations with the cost recovery community for a complete review of all aspects of the cost recovery regulations. A recommendation for a new, more equitable methodology will be made by the second quarter of 1999-2000. Also, a review of the financial planning and reporting processes and a redesign of the management information systems are targeted for completion by the end of the fiscal year 1999-2000.

Costs of frontier activities are not recovered

13.79 In 1991, the Board was given administrative responsibility for overseeing oil and gas operations in frontier regions previously managed by the Canada Oil and Gas Lands Administration (the *NEB Act* was amended in 1994 to authorize this transfer of responsibilities). Responsibilities include regulating oil and gas exploration, development and production; enhancing worker safety; and protecting the environment. Other frontier activities of the NEB include calculating discovered and undiscovered hydrocarbon resources, and developing emergency environmental contingency plans that support and complement the Board's regulatory responsibilities. The total cost to the Board of its frontier activities is more than \$4 million annually.

13.80 The Minister of Energy in 1991 exempted these operations from cost recovery, because they were outside the scope of the Board's normal activities. The cost recovery regulations were modified in 1995 to empower the Board to decide which costs it could recover. In July 1998, the Board decided to continue the exemption of frontier activities from cost recovery, retroactive to 1995.

13.81 There are three producing fields in the frontier lands. The most significant one consists of 350 wells, a gas plant, oil treating facilities and six artificial islands in the Mackenzie River. Current production annually generates a five percent royalty and a one-third net profit interest for the government amounting to approximately \$7.5 million and \$50 million respectively. These amounts are collected through an agreement between the federal government and a petroleum company. Although frontier lands are federally owned, the royalty regime appears to be similar to provincial arrangements.

13.82 The Board has seen its workload as administrator of frontier activities increase since 1994 and it anticipates more frontier activity in the near future. It may be appropriate to take a fresh look at frontier costs. Any future change to allow for cost recovery from the companies active in the frontier lands will need to be accompanied by an amendment to section 24(1) of the *NEB Act*.

Challenges to Reporting on Performance

13.83 Unlike companies in the private sector, organizations such as the NEB cannot measure their performance by reference to a conventional bottom-line profit or loss. As a public sector entity, the NEB has to find different ways to demonstrate whether its results meet the expectations of its stakeholders.

13.84 Traditionally, government agencies have shown how they have spent their budgets but often not what they have achieved. This is changing as entities like the NEB are increasingly challenged to report the results they have achieved. This is particularly appropriate for the NEB, having reorganized itself into a team-based structure focussed on results and having adopted a new accountability framework. Furthermore, the NEB was part of a pilot project in late 1996 to identify and report on its performance for the fiscal year ended 31 March 1996.

13.85 Our April 1997 Report Chapter 5, "Reporting Performance in the Expenditure Management System", identified five elements 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.

13.86 A significant part of the challenge for an organization moving into performance measurement and reporting is the need for visible commitment by senior management. The corporate culture also needs to change, as staff come to accept that different things not previously selected will be measured and reported. Another challenge is to accept and report results that may be less than favourable, and to learn from the experience.

Need for clear expectations

13.87 As organizations adapt to performance measurement and reporting, they need to adopt a multi-year perspective with critical analysis of what has and has not worked, and to be willing to change what has not. Sometimes it is helpful to benchmark an organization against similar entities, both to identify performance measures and to compare relative performance achievements. To improve accountability, it is important that performance indicators be focussed and stated clearly.

13.88 The NEB has made a good start toward identifying and reporting on its performance. It has developed a Report on Plans and Priorities, backed up by more detailed work plans, that identifies the elements of performance measurement, including performance indicators. But it will need to review its progress critically, and adapt in a number of areas. First, it needs to set clear performance expectations. Second, it needs to harmonize them between its plans and priorities document and its Performance Report. Third, it needs credible reporting of its actual performance.

13.89 The NEB's performance indicators still focus more on activities and outputs than on outcomes. The 1998-99 Report on Plans and Priorities identifies 44 performance indicators. It would be preferable to identify fewer indicators that can be linked directly to outcomes of the organization. This would provide for a more in-depth analysis of its performance. When selecting indicators, it is important to keep in mind that information for performance reporting needs to be of value internally as well as effective for external accountability.

13.90 Currently, some of the NEB's performance indicators change from year to year. Although performance indicators may evolve over time, if the NEB decides to change them it ought to be able to demonstrate why, and provide some continuity in its documents for the purpose of assessment.

13.91 In the 1997-98 Report on Plans and Priorities, the "expected results" could correspond better with the "strategies" to be used to achieve them. Presently, it is unclear how the expected results will be achieved or measured. Additionally, the 1996-97 Performance Report did not restate previous performance expectations; it noted only some direct outputs of the organization. A stronger link between the NEB's stated expectations and the results it has achieved would result in a more useful performance report for accountability purposes.

Reporting results achieved

13.92 The NEB will need to change its culture to fully embrace performance reporting. It has no system developed to track results against objectives, or to report periodically to its Executive with suggestions for change. Performance measurement and monitoring in a results-oriented organization needs to be an integral part of management. For performance measurement and reporting to continue to be a positive and productive process, it is important that the NEB monitor its performance strategically, regularly and consistently.

13.93 Preparation of the NEB's annual Performance Report is delegated to a staff person in Finance, who has to try to obtain information from the teams and co-ordinate it in some meaningful way. It would be preferable for each business unit to have a Performance Report co-ordinator, who can track results regularly and meet periodically with

counterparts in other units and the NEB performance reporting facilitator to consolidate the information for internal and external reporting.

13.94 With a designated person in each unit, the NEB could have better assurance that the data are accurate and meaningful. For example, we noted that the 1996-97 Performance Report presented a comparison of application cycle times for the years 1995 and 1996. The report did not mention that the comparison excluded the time between receipt of the application and the Board's issuance of directions on procedures. This represented about 10 additional weeks (see Exhibit 13.8). Incomplete information does not provide a reasonable basis for accountability and could prove embarrassing to the NEB.

Exhibit 13.8 is not available, see the Report.

13.95 It is important that the NEB continually compare performance accomplishments against expectations. We encourage it to have each business unit produce a "Best Practices Review", as the Applications Business Unit does, to learn from experience and improve performance measurement and reporting.

13.96 Linking costs to results. The Treasury Board Secretariat guidelines suggest that key performance accomplishments linked to expectations, mission statements and objectives should include the important aspects of results achieved, and their costs.

13.97 However, the NEB's 1996-97 Performance Report does not identify the costs and other financial information associated with performance. Although it reports by activity on planned spending compared with actual spending, the NEB needs to include an explanation of where and why it overspent or saved. It could then demonstrate more effectively how actual results compared with those originally expected.

13.98 As it continues its efforts to manage for results, the National Energy Board should:

- **improve the clarity of its expectations;**
- **monitor its performance regularly and make adjustments as needed;**
- **state clearly the results it has achieved and at what cost; and**
- **designate a co-ordinator for each business unit to monitor key performance indicators.**

Board's response: The Board accepts the recommendations. The Board recently hired a team leader for planning and reporting, who has started a review of financial planning and reporting processes and is designing a training program for users of the management information systems. A new individual performance management process called "FOCUS" was introduced in April 1998, and a strategic planning process will be started in September 1998. These are seen as critical first steps to both increase the individual's and the organization's performance and improve the processes to report on that performance.

Audit and Evaluation

13.99 Program evaluation and internal audit are valuable management tools in assessing whether programs are still relevant and cost-effective. In the past two years, the NEB has planned 12 internal audits but carried out only five. No evaluations have been conducted since 1994, and it has been at least eight years since important areas such as exports and imports, pipeline facilities applications, safety, and tolls and tariffs were reviewed. Audit and evaluation budgets have declined from 1.7 percent of expenditures four years ago to about 0.3 percent now.

13.100 The Audit and Evaluation unit consists of only one person. Given that some planned audit work has not been carried out and that even the small budget has not always been used, one could question whether the Executive sees this function as adding value to the NEB and whether it is prepared to use it as a key management tool.

Need for an evaluation

13.101 With its role evolving in response to changing market conditions, the NEB needs to be able to answer critics who question whether it is still relevant and effective. Once seen as the guardian of Canada's energy security, the Board now approves exports conditional on Canadian access at competitive prices. Operational changes have preceded legislative amendments, and with the advent of NAFTA the role of the Board has become more oriented toward business. New responsibilities have emerged in the safety and environmental areas. In this climate of significant change, the NEB would do well to commission an evaluation to assess the effectiveness of its program and its continued relevance.

13.102 The National Energy Board should reinforce its audit and evaluation function and commission an evaluation.

Board's response: While the Board was initiating a profound business transformation and reorganization over the last two years, we chose to limit the number of internal audit projects. Now that we have moved to the implementation of our Vision and the rate of internally generated change has gone down, we agree that we ought to reinforce our audit and evaluation function. The NEB will adopt an explicit audit and evaluation program by 1 April 1999.

The Board also agrees that the time has come for an evaluation of the program's effectiveness. The NEB will consult with our stakeholders, including the policy arm of government, to determine the value of an evaluation of the program's continued relevance. We undertake to determine the scope of the evaluation and its timetable by 1 April 1999.

Conclusion

13.103 In the areas we examined, the National Energy Board has adapted its regulations and processes to the changing energy market. In our opinion, however, the NEB needs to improve some of its management processes and operational practices to minimize the risk of being unable to fulfil its regulatory obligations and cope with the challenges ahead. The NEB needs to reassess its current level of resources and determine whether they are appropriately allocated to do the job cost-effectively. We also believe that it needs to undertake an evaluation to assess the effectiveness of its program and the extent to which it continues to be relevant.

About the Audit

Objectives

Our overall audit objective was to assess whether the National Energy Board was fulfilling its obligations as a regulatory body in the areas subject to examination, and specifically whether it has:

- identified changing circumstances;
- used appropriate surveillance and enforcement methods;
- developed effective management interfaces with other jurisdictions;
- established efficient and cost-effective operations and cost recovery practices; and
- carried out appropriate monitoring and reporting of operations and managerial performance.

Scope

We examined key management and operational processes, including:

- human resources management;
- financial surveillance of tolls and tariffs;
- cost recovery;
- performance measurement and reporting;
- environment and safety audits and inspections;
- pipeline accident investigations; and
- internal audit and evaluation.

Criteria

We developed criteria related to our audit objectives, which were discussed and agreed to by management.

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Chapter 14

Indian and Northern Affairs Canada

Comprehensive Land Claims

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Indian and Northern Affairs Canada

Comprehensive Land Claims

Main Points

14.1 Comprehensive land claim settlements are modern treaties that are significant not only to Aboriginal communities but also to all Canadians. Settlements involve the payment by the federal government to Aboriginal groups of almost two billion dollars and the clarification of various rights, including full ownership of over a half-million square kilometres of land. The first modern negotiated settlement of a comprehensive land claim was signed in 1975, and the most recent settlement was reached in July 1997. As of July 1997, 12 claims had been settled. Actual and potential claims involving over 200 First Nations are still to be settled.

14.2 The Government of Canada has chosen to settle these claims by negotiation rather than litigation or other means. Indian and Northern Affairs Canada is the lead federal representative in negotiations, with participation of other federal departments as appropriate. Other parties include the territorial governments, provincial governments, and the claimants. Although the Department bears significant accountability for results, it is not the only party that should be accountable; the good will and political resolve of all participants are needed in order to achieve appropriate settlements.

14.3 The government has reported that negotiated settlements establish certainty to land title and access to land and resources. However, removing uncertainty involves much more than signing an agreement. Among other things, successful implementation of settlements is critical to achieving the intent of these treaties. Implementation involves hundreds of projects with joint or separate participation of the parties. We found deficiencies in implementation, including inadequate or non-existent implementation plans, and the need to improve monitoring, reporting and evaluating.

14.4 Indian and Northern Affairs Canada has not demonstrated that it has always exercised adequate rigour in determining the nature and amount of assets that may ultimately be included in final settlements, including such considerations as the amounts of cash, land and other resources.

14.5 Settlements can take over 20 years to reach. Delays have had many causes. In our view, these long time frames do not contribute to cost effectiveness, and may result in less desirable outcomes for all concerned.

Introduction

Comprehensive land claims — What are they?

14.6 The Government of Canada describes comprehensive land claims as claims relating to ongoing Aboriginal title to land and rights that have not been dealt with by treaties or law. At issue are Aboriginal assertions that their rights have been disregarded, that such rights are guaranteed by the Constitution (1982), and that claim settlements are needlessly slow and do not provide sufficient compensation, land and recognition of rights. We note the importance of land in Aboriginal culture and its relevance to inherent rights of self-government. Another category of claims, specific claims, deals with alleged treaty violations and related matters; these are not the subject of this audit.

14.7 Settling comprehensive land claims involves negotiating and implementing complex, modern treaties. According to the Department, claim settlements act as a springboard for First Nations self-government and may include concurrent or subsequent development of self-government agreements.

14.8 The transfer of ownership of and rights to large tracts of land and resources and the payment of substantial amounts of money to Aboriginal communities are usually the major features of a claim settlement. Benefits to the claimants can include participation in resource management, including water, wildlife, and subsurface and offshore assets, and in resource and revenue sharing.

14.9 Among other things, the government believes that negotiated settlements avoid litigation against it, thus resolving the legal ambiguities associated with the common-law concepts of Aboriginal rights. According to the government, settlements exchange undefined rights for explicit rights under the agreements.

Significance of land claim settlements

14.10 The first modern comprehensive land claim settlement was reached in 1975 and, as of May 1998, the most recent settlement had been in July 1997. The geographic areas covered by settled and unsettled comprehensive land claims include most lands in the territories, most of British Columbia, a significant area of Quebec and smaller areas in other parts of Canada.

14.11 As of July 1997, 12 claims, including six under an umbrella claim by 14 First Nations, had been settled. These involved 48,000 Aboriginal people, full ownership of over a half-million square kilometres of land, a financial package totalling \$1.8 billion and other considerations. Details are set out in Exhibit 14.1. Implementation of the agreements continues and payments will continue until at least 2012. The Department plans to spend \$262 million on comprehensive claims in 1998-99, although it does not clearly disclose in its Estimates to Parliament the amounts for negotiating them, for implementing them and for making payments under them.

Exhibit 14.1

Selected Features of Settled Comprehensive Land Claims

	Date of Final Agreement	Settlement Amount Federal Share ¹ (\$ millions)	Settlement Land ² (sq. km.)	Settlement Beneficiaries ³
James Bay and Northern Quebec	Nov. 1975	35	14,000	18,100

Northeastern Quebec	Jan. 1978	1	326	600
Inuvialuit	June 1984	170	91,000	2,500
Gwich'in ⁴	Apr. 1992	75	23,976	2,200
Nunavut	May 1993	580	351,000	19,500
Yukon First Nations ⁵	May 1993	28	2,396	678
Champagne and Aishihik	May 1993	15	4,740	434
Nacho Nyak Dun	May 1993	19	2,396	512
Teslin Tlingit	May 1993	19	7,744	432
Vuntut Gwitchin	July 1997	16	2,590	484
Little Salmon/Carmacks Selkirk	July 1997	17	4,740	469
Sahtu Dene and Metis	Sept. 1993	75	41,437	2,288
Total		1,050	546,345	48,197

Notes:

¹ The amounts are expressed in net present value at the time of settlement, except the James Bay and Northern Quebec and Inuvialuit agreements, which are in current dollars. The total amount payable in current dollars by the federal government for capital transfers is \$1.8 billion, which includes interest where applicable.

² This land is full ownership land in accordance with the agreement. Agreements also provide for various rights respecting other lands.

³ Population is the most current estimate available.

⁴ 22,422 sq. km. in Northwest Territories and 1,554 sq. km. in Yukon.

⁵ Numbers in exhibit are 6 out of 14 First Nations in Yukon. For all 14, the umbrella total settlement amount is \$242.7 million and 41,440 sq. km.

Source: Indian and Northern Affairs Canada and Final Agreements

14.12 As of June 1998, there were 70 claims in various stages of negotiation and pre-negotiation discussion, or with accepted statements of intent to negotiate, including 52 in British Columbia and 18 outside B.C. There are 123 bands who have registered their intention to proceed under the British Columbia Treaty Commission process.

14.13 During the summer of 1998, steps toward the completion of the Nisga'a Treaty in British Columbia were being finalized outside the British Columbia Treaty Commission process. Since the treaty was in final negotiation at the time of our audit, we did not review how it was reached or the results achieved.

Parties to a claim and the claims process

14.14 Under the best of circumstances, reaching comprehensive land claim settlements is a very difficult challenge. Parties to a claim generally include the federal government, territorial or provincial governments and the claimant Aboriginal groups. Each party to a settlement agreement accepts rights and responsibilities either jointly or separately under very complex and voluminous agreements.

14.15 Final settlements can take more than 20 years to reach. This is partly because of the number of parties involved and the complexity of the claims. In addition, the motivation and the negotiation strategies of the parties can directly affect the speed, cost and content of settlements.

14.16 Although the Parliament of Canada has jurisdiction in matters relating to Indians and lands reserved for Indians, co-operation in settling claims is needed from the territorial and provincial governments with respect to certain lands that fall under their jurisdiction. For example, most treaties in British Columbia are addressed through the British Columbia Treaty Commission, established by the governments of Canada and British Columbia and the First Nations Summit.

14.17 The claims process outside of British Columbia, as set out in Exhibit 14.2, begins with research and submission of a claim by the claimant group(s), followed by its validation by government and then negotiations for settlement. The federal government is represented by Indian and Northern Affairs Canada as the lead department, with participation by the Department of Justice and other departments as appropriate.

Exhibit 14.2 is not available, see the Report.

14.18 Claims are negotiated by negotiating teams with various working groups and committees. Major events in the process include reaching a framework agreement to establish the scope of negotiations, reaching an agreement in principle that sets out, among other things, the financial amounts and land, and reaching the final settlement agreement and implementing it. The importance of claims settlements is further signalled by Cabinet's approval of negotiating mandates and by settlement legislation.

Comprehensive land claims policy and objectives

14.19 The evolution of claims policy and objectives has been greatly influenced by jurisprudence. In the *Calder* case in 1973, the Supreme Court of Canada acknowledged the existence of Aboriginal title in Canadian law. According to the Department, this decision and other jurisprudence, reviews and ongoing claims negotiations between 1973 and 1985 set the stage for rethinking the federal government's position on comprehensive land claims. The current claims policy and objectives were developed during this period and were published in 1986.

14.20 The policy objectives state:

The purpose of settlement agreements is to provide certainty and clarity to ownership and use of land and resources in those areas of Canada where Aboriginal title has not been dealt with by treaty or superseded by law. Final settlements must therefore result in certainty and predictability with respect to the use and disposition of lands affected by the settlements. When the agreement comes into effect, certainty will be established as to the ownership rights and the application of laws.

14.21 Settlement agreements contain surrender provisions pertaining to certain Aboriginal rights. For example, a 1993 final agreement states that the First Nation and the people eligible to be represented by it cede, release and surrender to her Majesty all their Aboriginal claims, rights, titles and interests in and to non-settlement land and all other land and water within Canada, with some exceptions. The government sees this as a means of removing uncertainty that is deemed to be a barrier to economic development.

14.22 Pressures on claims and claims policy persist. A notable example is the *Delgamuukw* case in which 58,000 square kilometres of northwestern British Columbia were claimed. The case commenced in 1984 and was ultimately decided by the Supreme Court of Canada in December 1997.

14.23 The Supreme Court did not render a decision on the claimed land. However, it further defined the scope of Aboriginal title and related rights and stated that oral evidence pertaining to the acceptability of the claim should

have been more liberally accepted at trial. The Court also ordered that a new trial be held if a negotiated settlement could not be reached. Aboriginal groups have considered this decision as support for their interests, and the government has indicated that it will be exploring the implications of the decision with the parties.

Fairness of the claim settlement approach

14.24 Comprehensive land claims negotiations can be adversarial. For example, First Nations have attempted to advance their positions by using the courts and other approaches. The difference between the financial, technical and legal resources available to the federal government and those accessible to communities of a few hundred or a few thousand Aboriginal people can be substantial. Given that the Crown holds the claimed land, it is important that the approach used to resolve such claims is seen to be fair, objective and credible.

14.25 We found that for settled claims the approach was largely controlled by the federal government. It decided what criteria would be applied for accepting claims and how much funding would be provided to the claimants to research and negotiate their claims. In addition, the government's policy set out the framework for reaching and implementing settlements.

14.26 In pursuing its objectives, the government needs to fairly represent all Canadians, who are ultimately bound by the agreements reached. Concurrently, the government has certain responsibilities and obligations for First Nations that do not apply to other Canadians in general. Because the need to balance diverse interests in settling land claims poses a difficult challenge, it may be optimistic to expect all parties to conclude that the process and outcomes were fair.

Focus of the audit

14.27 This audit focussed on the role of Indian and Northern Affairs Canada in reaching and implementing comprehensive land claims settled up to July 1997. It took into account that achieving appropriate results requires the good will and resolve of all parties involved. Further details on the audit objective, scope, approach and criteria are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Achievements and Results

Establishment of certainty

14.28 Since 1975, the government has finalized 12 comprehensive land claim settlements. The Department's 1998-99 Plans and Priorities Report tabled in Parliament states that negotiated settlements establish certainty to land title and access to lands and resources, avoid time-consuming litigation and create a climate that fosters economic development. Reaching a treaty is viewed by the Department not as an end in itself, but rather as a beginning in which Aboriginal people start to regain control of their destiny.

14.29 We noted that settlement agreements address, among other things, ownership of land. The importance of claim settlements to Aboriginal peoples and government can be demonstrated by the scope of an existing mature settlement. The agreement provides for the implementation of challenging responsibilities, as shown in Exhibit 14.3.

Exhibit 14.3

Examples of Areas Covered by Claim Settlements

Lands and Resources	Building Self-sufficiency
<ul style="list-style-type: none"> • surface and subsurface resources • wildlife and fish management • inland waters • offshore interests • general management rights • third-party interests • presettlement rights • environmental management 	<ul style="list-style-type: none"> • financial component • resource and revenue sharing • economic development measures • training • political, social and cultural interests • self-government

Source: Office of the Auditor General of Canada

14.30 We recognize that certainty can mean different things to different parties. And, without a consensus on interpretation, it becomes more difficult to determine what exactly is being achieved through negotiated settlements. The risk is that the parties may have agreed on the negotiated outcomes, but have different views on and expectations of the benefits and obligations set out in the signed agreements.

14.31 We believe that the parties must consider that a strict technical or legal interpretation of certainty may not be sufficient if they wish to reach and implement settlements in harmony.

14.32 After its 1981 review of its policy, the Department noted that Aboriginal groups continued to be dissatisfied with the policy. In particular, claimants objected to a policy that they believed attempted to extinguish Aboriginal rights in exchange for specific benefits provided under a settlement agreement.

14.33 Notwithstanding these concerns, settlement agreements have continued to contain extinguishment or surrender clauses pertaining to Aboriginal rights such as hunting, fishing and trapping. Aboriginal groups have continued to assert their rights, as they believe that surrender clauses extinguish their identity, beliefs and way of life. We do not judge the merits of such assertions but note that they can affect certainty from a practical standpoint, such as investor confidence in the areas in question.

14.34 Moreover, certainty and intended benefits are contingent not only upon unanimity of intent but also on post-settlement events. This is because settlement agreements typically comprise hundreds of pages of terms and conditions that may be interpreted differently by the numerous parties after the agreements are finalized.

14.35 In addition, even where there is a consensus on interpretation, the implementation of the agreements by all parties to their satisfaction is crucial to fostering the effective relationships necessary for success.

14.36 While implementation in good faith may be considered a normal expectation, we noted lawsuits against the Crown because of alleged implementation failures and disputes over interpretation of the agreements. The section on implementation disputes elaborates on these claims.

14.37 Litigation against the government can arise in a variety of circumstances, and is not unique to matters relating to comprehensive land claims. Nevertheless, litigation can compromise the establishment of certainty through negotiated settlements.

14.38 In 1994, the Minister of Indian Affairs and Northern Development ordered a major study on surrender and certainty issues affecting the negotiation of land claim agreements. The study report, by a senior jurist, was issued in

1995. Among the many discussions on certainty, it noted, “there is certainty when both sides are happy with the result.” A number of observations raised in the study are set out in Exhibit 14.4.

Exhibit 14.4

Some Observations on the Question of Certainty

- In a narrow legal sense, it may be that certainty was achieved by the surrender and extinguishment of Aboriginal rights. However, in the broader sense of surrender, Aboriginal people consistently maintain their position that treaties were/are not intended to extinguish Aboriginal title. Historical research confirms this was the Aboriginal understanding when treaties were entered into. Further, Aboriginal people can be expected to seek relief from “extinguishment” concessions through litigation, notwithstanding the surrender language in treaty documents.
- The continuing litigation of claim settlement agreements indicates that certainty in the broad, not necessarily the legal, sense of acceptance and common understanding has not been achieved. Whatever common understanding there may have been starts to disintegrate after an agreement is struck. That is, each party sees in the agreement what it had intended to gain rather than what was finally agreed upon.
- For many Aboriginal people, the certainty that is sought is the assurance that treaties (agreements) will be implemented and their rights and benefits respected.
- Several non-parties to settlement agreements believe that certainty cannot always be absolute. In their view, the problem is to define certainty in the relationship with Aboriginal people as a basis for planning and carrying out activities.

Source: 1995 Report of Hon. A. C. Hamilton

14.39 The report emphasizes that explicit recognition of Aboriginal rights needs to be included in any treaty, and concludes that certainty can be achieved without the surrender of rights provisions contained in recent settlement agreements.

14.40 The Department confirms that it is committed to the exploration of possible methods, other than the surrender or extinguishment of Aboriginal rights or Aboriginal title, that would provide clarity, stability and certainty through comprehensive claims settlements. Those methods would need to be supported by federal and provincial governments, First Nations and the public.

Economic development

14.41 We expected to find valid studies on economic benefits, suggested by the claims policy, that resulted from settlements reached many years ago. This information would be necessary to demonstrate the advantages of and accountability for achieving the objectives, consistent with the enormity and importance of such settlements.

14.42 The Department provided four study reports on land claims and economic interests reported in 1990 (two reports), 1995 and 1996. They relate to British Columbia, where no final settlements have been reached. One report attempts to place an economic value on uncertainty. It discusses the cost of not settling land claims in specific sectors of the B.C. economy. The other reports identify the perspectives of selected third parties and describe potential benefits of settling claims.

14.43 The Department has not carried out studies on the benefits of settlements reached in the mid-1970s and '80s in the far North and other parts of Canada. Accordingly, we believe that the Department has not done enough to demonstrate the deemed benefits relating to the economic impacts of negotiated settlements.

Other factors affecting results

14.44 Many factors can affect the achievement of certainty. For example, the preparedness of First Nations to discharge their responsibilities under settlement agreements is not uniform. We obtained from the Department a sample of management and accountability self-assessments by First Nations who were either considered ready to negotiate a claim settlement or had reached one. The assessments revealed deficiencies in the capacity of a number of First Nations to manage their affairs, including funding arrangements with the government. In our view, such deficiencies do not augur well for reaching and implementing claim settlements. In at least two claim settlements, the parties have recognized the need for implementation training.

14.45 Overall, we conclude that the establishment of certainty through these agreements may remain elusive in the practical sense.

14.46 To help enhance the achievement of certainty, Indian and Northern Affairs Canada should further address differing expectations of the parties relating to rights, capacity and implementation needs.

Reaching a Settlement

Accepting and validating a claim

14.47 According to the Department, the criteria applied to decide the acceptability of a claim for negotiation, as set out in Exhibit 14.5, were derived from common-law tests that determine continuing Aboriginal rights. In this regard, the Department relies on the Department of Justice to provide appropriate legal advice. These interpretations and their applications were not included in the scope of this audit.

Exhibit 14.5

Criteria for Accepting a Claim

- The Aboriginal group is, and was, an organized society.
- The organized society has occupied the specific territory over which it asserts Aboriginal title since time immemorial, and the traditional use and occupancy of the territory must have been sufficient to be an established fact at the time of assertion of sovereignty by European nations.
- The occupation of the territory by the Aboriginal group was largely to the exclusion of other organized societies.
- The Aboriginal group can demonstrate some continuing current use and occupancy of the land for traditional purposes.
- The group's Aboriginal title and rights to resources have not been dealt with by treaty.
- Aboriginal title has not been eliminated by other lawful means.

Source: Indian and Northern Affairs Canada

14.48 The Department is considering possible implications for the current claims policy and approach to settlements as a result of the December 1997 Supreme Court decision in the *Delgamuukw* case.

Establishing financial amounts, land transfers and other considerations

14.49 Major components of settlement agreements include financial amounts, transfer of ownership of and rights to land, resources and other benefits. We sought to determine whether appropriate information and a reasonable approach were used by Indian and Northern Affairs Canada to arrive at the selected components in the agreements.

14.50 Land claim settlements are the product of negotiations that usually involve a redistribution of significant assets, including land, cash and income from resource exploitation, previously held by the Crown on behalf of all Canadians.

14.51 Indian and Northern Affairs Canada needs to use adequate information and a suitable approach in determining the nature and amount of assets that may ultimately be included in final settlements. For example, information on the existence and potential value of surface and subsurface resources would be important, in our view, for the Department to use. And, due consideration of alternative approaches would be expected. However, the Department has not demonstrated that it has always exercised adequate rigour when making such determinations.

14.52 We noted that questions or concerns were raised within the Department about how settlements were being reached. For example, with respect to a number of settlements, the Department did not have studies of the claimed lands that it believed were reliable, land allocations did not take into account the impact of transferring such land, and the determination of resource royalty sharing was done without the use of detailed data on resource potential.

Relations with the Department of Justice

14.53 We found that the Department of Justice often raises issues to be addressed by Indian and Northern Affairs Canada during the settlement of a claim. We expected the Department to follow the advice of Justice or, alternatively, provide valid reasons when such advice was not followed.

14.54 For example, we observed one case where Justice had noted a number of outstanding issues within six months of the agreement signing date. According to Justice, the issues could not be resolved at the legal review stage because of disagreement between the claimants and the government, disagreement between Justice and federal negotiators, apparent time pressure to initial the final agreement, and the desire to maintain comparability with previous land claim settlements.

14.55 The Department of Justice further observed that while these matters would not cause it to oppose ratification by government of the agreement, it believed that the imminent final agreement was not as clear as it should have been. We noted that approximately two years after the agreement was signed, the claimant party filed a lawsuit against the government on one of the significant outstanding issues. The case was still in litigation at the time of our audit.

14.56 We were unable to determine if the above-noted case was an isolated one or if other concerns raised by Justice on claims are routinely and appropriately addressed before settlement agreements are signed. However, we were advised by Indian and Northern Affairs Canada that it would not support a settlement proposal if the Department of Justice had any significant, unresolved concerns.

14.57 We also noted that Indian and Northern Affairs Canada does not request an overall assessment from the Department of Justice on the final settlement before it is signed. We believe that such assessments are necessary to enhance the accountability of the federal parties and to reduce the risk that unintended interpretations of the terms of the agreements could be made.

Time cycle to finalize an agreement

14.58 Reaching a final settlement agreement is generally a lengthy affair that can take over 20 years. However, there is no proven guideline that suggests an optimum time frame in which a settlement can best be reached. This leaves only the perception of reasonableness by the parties and non-parties to a settlement as a possible indicator of whether the time taken is acceptable.

14.59 As a result of a court action by First Nations and related events in 1972, negotiations commenced in 1973 to settle two claims that were finalized in 1975. These were the first negotiated modern comprehensive land claim settlements and took the least time to reach a final agreement. Examples of other settlement time frames are set out in Exhibit 14.6.

Exhibit 14.6

Examples of Land Claim Settlement Time Frames as of May 1998

- A claim submitted in 1973 and revised and resubmitted in 1977 was accepted for negotiation in 1978; settlement was reached in 1993.
- Combined claims from five Aboriginal groups were accepted for negotiation in 1976 and 1977. In 1990 a final agreement was reached; however, three of the groups later withdrew from this agreement and their claims are still outstanding. Final settlements were again reached with the other two groups in 1992 and 1993, using the failed 1990 agreement as the basis for negotiations.
- A claim submitted in 1977 was accepted for negotiation in 1978 and settlement was reached in 1984.
- A joint claim from 14 First Nations was submitted and accepted for negotiation in 1973. Settlements were ultimately reached with four First Nations in 1993 and with two more in 1997. Settlements with the remaining eight First Nations are still outstanding.

Source: Office of the Auditor General of Canada

14.60 As indicated in the exhibit, the time taken to reach 10 of 12 settlements ranged from 6 to 24 years (with most over 14 years) after a claim had been accepted for negotiation. Moreover, settlements with eight First Nations will take more than 24 years to settle. Three additional claims that had been accepted for negotiation in the 1970s are still unresolved.

14.61 In 1986 the Department acknowledged concerns in its claims policy about the lack of progress in negotiations. Further, in 1998 a major Aboriginal organization indicated that settlements take much too long to reach.

14.62 We acknowledge that the reasons for protracted settlements are complex and can be attributed to all parties to a claim, although we do not attribute them to any individual party. Reasons may include the lack of willingness by some jurisdictions to recognize a claim, the nature of the parties' negotiating strategies, the need to meet political objectives, the concurrent connection to self-government negotiations, and the possible impact of non-party interests.

14.63 However, the way in which the claims process is managed can also contribute to protracted settlements. In some settlements, we noted the following deficiencies:

- There was no overall plan at the beginning of the process that identified the responsibilities of the parties, including other federal departments, and specified target dates for key events, against which progress could be measured.
- Final settlement deadlines were either not set or not met.

- Established procedures for federal and territorial parties were not always followed and negotiations deviated from established mandates, according to departmental information.

14.64 In our view, protracted settlements do not contribute to cost effectiveness and may result in less desirable outcomes for all concerned. In addition, the benefits of expected economic development in the disputed areas may be delayed.

14.65 Indian and Northern Affairs Canada should:

- **ensure that adequate rigour is always applied in determining the nature and amount of assets that are included in final settlements;**
- **obtain an overall assessment of the intended agreement from the Department of Justice before the government signs it; and**
- **together with the other parties to a claim, expedite the claims settlement process, in a cost-effective way.**

Implementation of Settlement Agreements

Responsibilities of the parties

14.66 We believe that a settlement agreement alone should not be considered a successful resolution of a claim unless it is implemented in a cost-effective way. To help achieve this as well as accountability for results, the responsibilities of the parties need to be clearly detailed in the agreements. Furthermore, clear, comprehensive and agreed-upon implementation plans must be developed and used appropriately.

14.67 Settlement agreements are complex, lengthy documents involving several parties and long time spans. Responsibilities of the parties may be joint or separate and Indian and Northern Affairs Canada, as the lead department, is the project manager for hundreds of obligations.

14.68 Although the Department is actively involved in the implementation of settlement agreements, we observed the need for improvement. In some cases, the provisions in recent settlement agreements can lead to implementation disputes. For example, a standard definition in several agreements states that government means the Government of Canada, the territorial government, or both, depending upon which government or governments have responsibility from time to time for the matter in question. This wording, coupled with the ongoing devolution of departmental responsibilities to the territories, increases the risk of ambiguity in implementation responsibilities.

Implementation plans

14.69 We noted that settlements reached prior to 1986 and still being implemented have only partial implementation plans or none at all. For example, an implementation plan for a settlement reached in 1975 was not completed until 1990, and it covers only one of two claimants to the settlement. In another case, settled in 1984, no implementation plan has been developed. The lack of comprehensive implementation plans makes it more difficult to determine progress and to identify problem areas as well as achievements.

14.70 Agreements reached after 1986 require implementation plans. The plans identify hundreds of implementation projects and activities in varying degrees of detail. In many cases, these projects are contingent upon other events that do not have designated time frames.

14.71 Implementation plans are attached to the agreements but are not part of them. With some exceptions, they are not intended to be contractual obligations. Consequently, although the plans are signed by the parties, their contribution to accountability and results is limited. According to the Department, the plans are only a guide because flexibility is needed. Given the significance of the land claim settlements and the difficult challenges to their successful implementation, we believe that implementation plans can and need to be more than a guide, while still providing the necessary flexibility.

Monitoring, reporting and evaluating

14.72 The Department uses various methods to monitor and report on implementation. One important method is the Land Claim Obligation System (LCOS) used by the Department to report the status of federal obligations. We found that LCOS is too general to be useful in assessing the status of certain obligations. In addition, LCOS tracks only activities and processes, not results produced and costs incurred.

14.73 As well, the matching of the obligations contained in settlement agreements to the implementation status reports is fragmented. This is because not all settlements are included in LCOS. For example, the status of obligations and activities pursuant to a settlement reached in 1984 is not routinely reported in LCOS. And, for those settlements that are included in LCOS, the system focusses only on the status of federal government obligations. Where LCOS identifies necessary action, time frames are not generally indicated. Thus, the conditions that led to the required action may be perpetuated.

14.74 In addition, when completion dates are identified, there is little evidence that progress has been tracked against these dates. As well, we could find no departmental criteria on how the adequacy of implementation would be assessed.

14.75 The status of obligations belonging to the other parties is reported separately by them or through implementation committees on which the Department is represented. Accordingly, the Department obtains information on the status of the other parties' obligations that can help it to discharge federal government obligations. However, consolidated reporting of all obligations at regular intervals in a standard format is not done on a timely basis. For example, for a 1993 settlement agreement, the only available consolidated internal status report, as of June 1998, covered the period ended March 1996. And, like LCOS, time frames for completion of necessary actions are not indicated.

14.76 In addition, a general review of a 1992 implementation plan, for five years ending in 1997, recommended that Canada and the territorial government organize a working group by June 1998 to review, implement and monitor the economic measures provided for in the related 1992 settlement agreement. Further, with respect to a 1975 agreement, the most recent implementation review published by the Department was in 1982.

14.77 In addition to LCOS monitoring reports, the Department co-ordinates the preparation of annual reports on the reviews of settlement agreements. These reports describe the implementation activities undertaken and this information is provided by the parties to the agreements and others who are involved in implementation. We believe these reports are a useful method of communicating the implementation of claim settlements. However, their usefulness could be enhanced by including information on the results and impacts of claim settlements on the affected communities.

14.78 With respect to evaluations, none of the four settlement agreements in the audit sample calls for an evaluation of all key implementation impacts, and none has been performed. One agreement, reached in 1984, requires a full and public review in the year 2000 of the efficacy of the provisions for economic measures, a delay of 16 years.

14.79 In another agreement, reached in 1993, there is a requirement to review the effectiveness of the provisions relating to economic development by 2010, a delay of 17 years.

14.80 Evaluating the implementation of settlement agreements could:

- assist the Department in discharging its broader responsibilities of its overall mandate;
- assist other parties in the implementation of the agreements;
- assist Aboriginal and non-Aboriginal communities in adjusting to or benefiting from the impacts of settlements; and
- enhance accountability for the implementation of settlement agreements.

14.81 We recognize that evaluating the impacts of claim settlements can be very complex and difficult. However, we believe that waiting for a period of 15 years or more to commence such evaluations increases the difficulties. The nature and potential magnitude of the effects of settlements suggest that such evaluations would best be carried out on a timely, periodic basis. This would allow information on results to be built up over time and, among other things, would provide the necessary information to guide future settlements.

Implementation disputes

14.82 The nature and scope of settlements suggest that occasional disagreements on implementation can occur. Indeed, settlement agreements usually provide for dispute resolution mechanisms. And, except as may be provided under the terms of the agreements, no party can prevent another from resorting to litigation. Although we do not take a position on any litigation, disputes that go to litigation raise questions about the effectiveness of the settlement agreements and their implementation.

14.83 Several lawsuits against the Crown came to our attention during the audit. Examples include one filed by a third party and three filed by First Nations. One case involving the first modern settlement is a 1996 claim for \$5.4 billion against Canada and other parties. First Nations are seeking relief for alleged breaches of obligations under the agreement. The allegations relate to:

- Aboriginal and treaty rights;
- social and environmental protection; and
- funding under the agreement for land use, tourism, health, education, training, employment, fishing, housing, capital items and other matters.

14.84 In another case, filed in 1997, a First Nation is seeking damages in connection with the alleged failure of Canada to establish the Land and Water Board to regulate land and water use throughout the settlement area. The Board was required under the settlement agreement signed in 1992. The lawsuit asks for \$2 million and an order requiring Canada to perform its obligations under the agreement.

14.85 In another case, filed in 1995, a First Nation alleges that the Crown is not allocating a proper share of resource royalties to the First Nation as required under the 1993 agreement. The matter stems from differing interpretations of the intent of the applicable clauses.

14.86 In a case filed in 1996 by a third party, compensation is being sought for alleged damages relating to the allocation of land under settlement agreements. The issue surrounds the disagreement between Canada and another jurisdiction involved in the land claim settlement over who is responsible for paying compensation that may be provided under the claim settlement. Although the two governments later reached an agreement on responsibility, the third party's claim is still outstanding.

14.87 Indian and Northern Affairs Canada, together with the other settlement parties, as applicable, should:

- **ensure that agreed-upon implementation plans contain adequate details regarding time frames, project costs, and cost sharing;**
- **address issues relating to fragmentation, completeness and timeliness of reporting; and**
- **perform periodic evaluations of settlement implementation on a timely basis.**

Costs to Reach and Implement Settlements

14.88 Determining and reporting accurate and complete cost information is important to help ensure the cost effectiveness of the claims process, the results produced, and accountability to Parliament. Costs are also needed to determine implementation budgets and sources of financing.

14.89 The Department does not report the complete costs of reaching and implementing settlement agreements. Although the costs of the financial compensation components of settlements are generally known, other costs associated with settlements have been identified only on a piecemeal basis, or not at all. Other costs include those involved in reaching a settlement, the potential value of transferred land ownership and access rights, consolidated costs of other federal departments involved in the claims process, costs of various projects under implementation plans and responsibilities under the agreements, and costs of resource and revenue sharing. For some things, only estimated costs may be identifiable. However, we believe that where actual costs cannot be determined, this fact should be disclosed so that the extent of accountability for reaching and implementing settlements can be clarified.

14.90 Indian and Northern Affairs Canada should report the complete costs of reaching and implementing settlements and compare them with relevant budgets.

The British Columbia Treaty Commission

14.91 The B.C. Region is unique in its approach to treaty settlements. The approach in this region is framed by the British Columbia Treaty Commission (BCTC) initiated by the federal government, the government of British Columbia, and the First Nations Summit in 1992.

14.92 In 1993, the BCTC began to receive statements of intent from First Nations wanting to enter the treaty process. The purpose of the BCTC is to facilitate the negotiation of treaties and related agreements. The duties of the Commission include:

- receiving statements of intent and assessing the readiness of the parties to commence a treaty negotiation according to predetermined criteria;
- encouraging timely negotiations and monitoring progress;

- allocating funding to First Nations;
- assisting the parties to obtain dispute resolution services;
- maintaining a public record of negotiations; and
- preparing annual reports for tabling in Parliament, the British Columbia Legislature and the First Nations Summit and for public distribution.

14.93 The Commission does not make binding orders, determine territorial boundaries, arbitrate disputes or negotiate on behalf of any party.

14.94 As the federal government’s representative in land claims in B.C., the Federal Treaty Negotiation Office of Indian and Northern Affairs Canada will not negotiate modern treaties with a First Nation who has not entered the BCTC process. In these instances, the only recourse available to the band is litigation. As of July 1998, 74 bands of a total of 197 bands in B.C. had not entered the process.

14.95 The BCTC treaty process involves six stages, as set out in Exhibit 14.7. Indian and Northern Affairs Canada relies on the BCTC for accepting First Nations into the treaty process. As of July 1998, 36 out of 51 negotiations were progressing toward a stage 4 agreement in principle; 15 were at earlier stages of the process.

Exhibit 14.7

British Columbia Treaty Commission Six–Stage Treaty Process

The treaty process entails:

- 1) the filing of a statement of intent by a First Nation;
- 2) preparation for negotiations, including a determination of readiness of the parties;
- 3) negotiation of a framework agreement;
- 4) negotiation of an agreement in principle;
- 5) negotiation to finalize a treaty; and
- 6) implementation of a treaty.

Source: British Columbia Treaty Commission

14.96 The Commission has identified several aspects of the treaty negotiation process that require attention, including:

- overlapping claims (by more than one First Nation);
- the differences among First Nations in their capacity to settle claims;
- the need for greater third–party consultations and education;
- appropriateness of when to suspend negotiations in the event of litigation;

- the capacity and resources of the governments of B.C. and Canada to enter into multiple, concurrent negotiations; and
- the adequacy of funding to First Nations for negotiations.

14.97 First Nations that have entered the process may be funded for their negotiations by repayable loans (80 percent) and contributions (20 percent). Canada provides all the loan funding and 60 percent of the contributions. The government of British Columbia provides 40 percent of the contributions. The Commission makes funding decisions subject to available resources.

14.98 As of early 1998, Canada's cumulative share of funding for treaty negotiations since 1994–95 was \$90 million. No settlements have been reached under this process. The BCTC indicated that it does not have the mandate to set deadlines. This raises questions about the time and cost implications for settling the demands of the 123 bands that have expressed interest in reaching treaties.

Non-Parties to a Claim

14.99 Settled claims can affect non-parties to the settlement. Examples include small but important businesses such as outfitting, larger enterprises such as mining, and First Nations that are not parties to a specific settlement but that have land or other interests that overlap settlement areas.

14.100 With respect to certain types of enterprise in some settlement areas, we found indications that little opportunity had been provided for their input to decisions on the allocation of land and other provisions in settlement agreements.

14.101 In one case, an association representing over 20 tourist businesses alleged, among other things, that the settled land had blocked their normal operating areas, preventing efficient access to big game and thus impeding their business. As well, they believe that settlement negotiations have omitted consideration of non-native historical land use and that the general population has not been adequately represented.

14.102 Another association reported its concerns about the lack of opportunity for input to the claims process and the lack of information on how land is selected for settlement.

14.103 We do not take a position on these perspectives and acknowledge that other types of enterprise may have other perspectives.

Perspectives of Selected First Nations Involved in Comprehensive Land Claims

14.104 Given the role of First Nations in the resolution of claims, we sought their perspectives on the claims process and results. These are set out in Exhibit 14.8. Again, we do not take a position on these perspectives.

Exhibit 14.8

Perspectives of Selected First Nations Involved in Comprehensive Land Claims

- The scope of the final agreement does not adequately cover the claim issues. Self-government-related issues remain unresolved and too much of the agreement is open to interpretation.

- The failure of Canada to establish the required Land and Water Boards is a concern.
- The settlement has created employment in their area and capital distribution of settlement compensation has enabled the start-up of businesses.
- The inefficiency of the settlement process has cost the community 31 percent of the value of its settlement compensation.
- Evolving common-law principles, self-government negotiations and the claim settlement agreement are not harmonious, thus increasing uncertainty.
- The wording of the settlement agreement is ambiguous, necessitating the use of dispute resolution provisions.
- The implementation plan is not attainable within a reasonable time frame because the funding provided to First Nations for implementation is insufficient.
- The funding was not based on a costing of responsibilities and activities as described in the plan, but was offered on a “take it or leave it” basis.
- Implementation is not proceeding efficiently and the post-settlement relationship between the parties is not harmonious.
- Self-government issues as perceived through the settlement agreement and implementation plan are not dealt with adequately.
- There are benefits of a parallel self-government agreement but “...the implementation of the final settlement agreement is comparable to paddling upstream against a very strong current...”

Source: Office of the Auditor General of Canada

Conclusion

14.105 Resolving comprehensive land claims is a difficult challenge for all those involved. The political will, expectations and good faith of all parties in negotiations can directly affect the content of settlement agreements, the time taken to reach and implement settlements, the cost effectiveness of the entire process and the overall results produced.

14.106 In considering the government’s objectives for negotiating claim settlements and how these could be achieved, we concluded that reaching an agreement is a significant milestone. However, it does not by itself constitute a complete achievement. There are some opportunities to resolve some fundamental issues.

14.107 We believe that the ultimate success of existing and future modern treaties will depend largely on how the parties define and act on their expectations for the removal of uncertainty and for the clarification of the rights of all parties. In addition, the parties’ satisfaction with implementation progress and results will be a significant factor that helps determine the long-term benefits of negotiating settlement agreements.

14.108 Since a significant number of claims have yet to be resolved, Indian and Northern Affairs Canada needs to address the matters and concerns identified in this chapter that fall within its responsibilities.

***Department’s response:** The Department is committed to resolving by negotiation, rather than litigation, issues of claims to Aboriginal rights and title in Canada. This approach was endorsed in the 1997 Supreme Court of Canada decision in Delgamuukw, which summed up the situation with the statement “Let us face it, we are all here to stay.” The first modern land claims agreement or treaty, the James Bay and Northern Quebec Agreement, was concluded in 1975. Since then, 12 final land claims agreements, one agreement in principle and 41 framework agreements were completed in areas of Canada not previously covered by treaty.*

The Auditor General's report reviews treaties negotiated over a period of more than 20 years, largely negotiated in the 1970s and 1980s, and highlights shortcomings of previous policies and practices, which have evolved considerably during this period. For example, as noted by the Auditor General, multi-party implementation plans have been negotiated to accompany all settlement agreements reached since 1986. For claims settled earlier, we had made efforts to negotiate implementation agreements after the fact, with success in most cases.

We agree with the Auditor General that there is always room for improvement in implementation monitoring and reporting practices. The Department is continually striving to improve these practices in concert with the other parties and stakeholders. In the early 1990s, the Department initiated a rigorous, multi-faceted regime of implementation monitoring and reporting against implementation plans. A consolidated annual report is prepared on the implementation of each settlement agreement for public distribution and tabling in Parliament. As well, many agreements call for comprehensive five-year reviews, the first of which is now being completed for the 1992 Gwich'in agreement.

Government's approach to achieving certainty in respect to lands and resources has also evolved since the 1970s, when the Crown had the power to extinguish Aboriginal title. The Constitution Act, 1982 protects existing Aboriginal rights from such unilateral action. New land claims agreements reflect evolution in this area as all parties struggle to find legal text to achieve certainty in regard to lands and resources. The lack of litigation to date over Aboriginal title in areas covered by these modern treaties is cause for optimism that the goal of legal certainty is being achieved. As the Auditor General has pointed out, however, the satisfaction of all of the parties with what has been negotiated, and the successful implementation of treaties, will contribute to the certainty of results far beyond the legal protection that governments and Aboriginal groups seek to obtain.

The negotiation process itself has also been greatly streamlined over the years. Since 1986, the negotiation of framework agreements as a first stage has allowed the parties to develop a relationship and clarify expectations by reaching agreement on subject matters, working procedures and target dates. Over two-thirds of those First Nations that have entered the British Columbia Treaty Commission process since its inception in 1993 have concluded framework agreements and embarked on agreement-in-principle negotiations.

All agree that further improvement is necessary in the length of time required to negotiate treaties. In partnership with Aboriginal groups, provincial governments and other stakeholders, we are exploring ways to accelerate the process, while respecting roles and relationships so that trust in the process and outcomes is maintained and enhanced. However, since treaty negotiations seek to resolve complex issues of long-term significance, governments as well as claimant groups must take the time required to satisfy themselves that the agreement will adequately address their interests for the future.

Another area that is being addressed is the capacity of Aboriginal groups with valid claims to conduct negotiations while at the same time undertaking other increased responsibilities, such as providing advice to governments on proposed development in their traditional territories. This issue is one that has been identified in the review of the British Columbia treaty process, and that the federal government has addressed by the establishment of a special capacity-building fund in that province. This is consistent with the Gathering Strength initiative (government's response to the report of the Royal Commission on Aboriginal Peoples), which sets out an approach for renewing the partnerships with Aboriginal people, supporting strong people, communities and economies, strengthening Aboriginal governance and developing a new fiscal relationship.

Internal practices have also seen improvements; for example, analyses of potential mineral values of possible settlement lands are now being used to support negotiations. Horizontal linkages between departments have been developed. In the treaty-making process, close collaboration with other departments is routine. In particular, the Department of Justice assigns counsel full time to negotiating teams to provide advice on chapters as they are being negotiated. As well, a full review is conducted throughout government departments prior to conclusion of framework agreements, agreements in principle and final agreements.

Costs of reaching and implementing settlements are contained in each department's Main Estimates and annual Performance Reports, as well as in Public Accounts. In addition, annual reports on the implementation of each settlement agreement provide useful summaries of most settlement and implementation expenditures. This department meets all required reporting and disclosure standards and has played a lead role among departments in improving reporting to Parliament, in particular by its horizontal display of Aboriginal expenditures by all departments. However, the publication of financial information on settlements in a manner that is comprehensive and accurate, yet easily understood, is a continual and complex challenge.

Canadians support the negotiation of land claims agreements to settle issues of long-standing concern and to allow Aboriginal citizens to participate fully in society by regaining control of their communities through self-government arrangements. Many lessons have been learned, and the process continues to evolve as new models are tried and all parties adapt to changing circumstances. While the stakes are high and the negotiations complex, we will continue to accept the challenge, since we believe that the negotiation of treaties will benefit all Canadians and contribute to Canada's international reputation as a country that can demonstrate peaceful ways of resolving our differences.

About the Audit

Objective

The main objective of the audit was to identify opportunities for improvements in the way claim settlements are being reached, implemented and reported, in the context of the government's objectives for settling claims.

Scope and Approach

The work was performed in selected regions of Indian and Northern Affairs Canada that continue to be significantly involved in comprehensive land claims. They included parts of British Columbia, the Northwest Territories, and Yukon. The audit also included a review of selected matters in the Department's headquarters in Ottawa. In addition, we inquired into the status of a 1975 claim settlement in Quebec.

We examined, in varying degrees, four settlements that had been finalized between 1984 and 1993 (at the start of the audit, 1993 was the year of the most recent settlement). These agreements provided an opportunity for reviewing all phases of a settlement while they continue to be implemented. The total value of the known, direct compensation of the four settlements is approximately \$350 million and the amount of land with full Aboriginal ownership covered by the agreements in the sample totals approximately 160,000 square kilometres in the North. In addition, we reviewed selected matters relating to other settlement agreements.

We also met with the British Columbia Treaty Commission to obtain an overview of its mandate and status of claims in the region and to explore certain issues. As well, we obtained the perspectives of selected First Nations involved in comprehensive land claims as well as some of those affected by them.

Criteria

We expected that:

- comprehensive land claim settlements would result in the removal of uncertainty, increased socio-economic development in the claimed areas, fairness to all parties and non-parties to the settlement and a reasonable determination and transfer of financial and other resources and rights;
- comprehensive land claim policies and procedures would be applied to every claim as intended by the government and in accordance with principles of cost effectiveness and accountability;
- settlement agreements would be reached in a timely manner and be properly implemented; and
- comprehensive land claim activities and results would be reported appropriately.

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Chapter 15

Promoting Integrity in Revenue Canada

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Promoting Integrity in Revenue Canada

Main Points

15.1 The success of Revenue Canada's programs depends largely upon voluntary compliance with tax requirements by individuals and businesses. We believe that one of the many factors affecting the likelihood of their voluntary compliance is their perception of the conduct of Revenue Canada's staff. An organization like Revenue Canada, with its decentralized operations and the extensive exercise of judgment by employees, must take adequate precautions to minimize the risk of employee misconduct. Our audit looked at various means that the Department employs to promote integrity among its employees.

15.2 All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. The Department investigates incidents of misconduct; discipline is imposed on employees found guilty of misconduct; and, on the whole, management takes appropriate action, where weaknesses are highlighted by incidents, to prevent similar misconduct. Further, distributing statements of its mission, vision and values and three key booklets on conduct are important steps Revenue Canada has taken toward promoting an ethical culture. Most employees have received some formal training on expected conduct.

15.3 There are areas where improvement will help Revenue Canada reinforce this sound foundation. Because the disciplinary process can be slow, its effectiveness as a deterrent to similar misconduct may be diminished. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than department-wide weaknesses. Further, information provided on values and conduct is not presented in a way that allows easy understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of expected values and conduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

Introduction

15.4 The success of Revenue Canada's tax, transfer payment, customs and trade administration functions depends primarily upon voluntary compliance with the applicable laws by individuals and businesses. For example, individuals are expected to report their income accurately and to pay the tax required by law; travellers entering Canada are expected to declare the nature and value of certain items that they bring into the country and to pay any duty required by law. Revenue Canada operates various facilitation programs to encourage compliance, and enforcement programs to detect those who are not compliant. For the most part, however, it depends not on these programs but on its expectation that the vast majority of people will comply with their obligations voluntarily.

15.5 We believe that one factor affecting the likelihood of voluntary compliance is the way individuals and businesses perceive the integrity of Revenue Canada's staff. Organizational integrity is thus an asset whose value lies, in part, in its influence on the behaviour of stakeholders with whom Revenue Canada does business. Like physical and financial assets, organizational integrity is something that demands investment, safeguarding and maintenance. This audit looked at how effectively Revenue Canada manages the asset we are calling "organizational integrity."

Focus of the audit

15.6 There is no single, consistent definition of control for organizations. In the narrowest sense, it means ensuring that specific procedures are followed. In the broadest sense, it means creating the conditions that lead to the achievement of the organization's objectives. This suggests that Revenue Canada, in controlling to minimize the occurrence of incidents of employee misconduct, brings a variety of elements to bear on the problem. In past audits of Revenue Canada, we have examined aspects of the Department's internal control systems. We have made recommendations on its internal controls, where we considered it necessary, and followed up to review the implementation of the recommendations. In this audit, we looked at elements that fall into two categories: elements of the Department's "culture," which includes what is sometimes referred to as "informal control"; and elements that represent the learning that takes place as a result of incidents having occurred.

15.7 In designing internal control systems, organizations typically focus a lot of attention on removing opportunities for employee misconduct. In our emphasis on organizational culture, we focussed on what keeps employees from behaving improperly even when opportunities for misconduct remain. Internal controls cannot function without formal and informal ethical support mechanisms; a strong ethical culture provides a guidepost for employee action. Our emphasis on learning from incidents of misconduct focussed on an important process by which organizations ensure that their policies, procedures and systems are responsive to newly discovered threats in their environments.

15.8 This is our second report on our work on the topic of ethics in the public service. The first one, a study reported in May 1995, dealt with ethics and fraud awareness in government. The study proposed an ethical framework for government. Elements of that framework, such as a statement of principles, leadership and training, were also addressed in this audit. The topic of ethics in a government environment is an important theme that will continue to command our attention.

15.9 In performing this audit, we concentrated on three of the Department's business lines at the operational level — collections, audit, and customs — as well as on certain headquarters functions. 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

The Environment in Revenue Canada

Like any organization, Revenue Canada is vulnerable to employee misconduct

15.10 It will come as no revelation that Revenue Canada is vulnerable to employee misconduct. In the past several years, a number of incidents have been reported publicly (see Exhibit 15.1):

- A collections officer became overzealous in his pursuit of a debt owed to Revenue Canada, inflicting financial and psychological distress upon the debtor.
- A manager accepted a bribe from a taxpayer suspected of tax evasion, in exchange for dropping the investigation.
- A collections officer devised a scheme for claiming fraudulent refunds of Goods and Services Tax.
- A manager colluded with a number of employees to make fraudulent claims for overtime pay and received kickbacks from the employees.
- A customs officer was charged as an “inside man” in a scheme involving the diversion to domestic use of liquor bound for export (and, therefore, excise–tax–free).
- A manager tried to convince several contractors to make fraudulent claims for the work they were undertaking for the Department and to pay the manager kickbacks.

Exhibit 15.1 is not available, see the Report.

15.11 We reviewed the documentation relating to all 285 incidents of potential employee misconduct reported to Revenue Canada’s Security Directorate during the period 1 January 1995 to 30 June 1996. The results of our review provide an indication of the kinds of vulnerability to employee misconduct that are present in Revenue Canada.

15.12 The most frequent kinds of reported incidents are described in Exhibit 15.2. Many of these incidents can be clearly associated with employees; other incidents cannot. A prime example of an incident that may not be possible to link specifically to employees is theft, since the Department does not necessarily know the perpetrator’s identity. When we completed our review of reported incidents, 69 of the 285 incidents had been referred outside the Department. Of the remainder, in 96 cases the occurrence of misconduct was confirmed and the offending employee was identified; in 115 cases either the occurrence of misconduct or the identity of the employee was not confirmed; and in 5 cases the investigation was still ongoing.

Exhibit 15.2 is not available, see the Report.

15.13 It is difficult to draw any conclusions about the rate at which incidents occur. Bearing in mind that Revenue Canada has approximately 40,000 employees, 285 incidents in 18 months may not seem like a particularly high number. At the same time, academic studies of other segments of society strongly suggest that the number of incidents of misconduct that are reported is much lower than the number of incidents that actually occur.

15.14 We believe that the nature of Revenue Canada’s operations makes it more vulnerable than many other departments and agencies to certain forms of employee misconduct. Like other departments that employ peace officers, Revenue Canada faces vulnerabilities associated with its customs operations. In addition, Revenue Canada is unrivalled among government departments in the scale of its collections and its audit operations — operations that also involve significant vulnerabilities.

15.15 The head of the federal government’s Task Force on Public Service Values and Ethics identified two conditions that are sources of ethical challenge for individual public servants: the exercise of judgment and discretion in decisions; and decentralization and delegation of authority. Both of these conditions are present in Revenue Canada. Whether it is a collections officer negotiating a payment schedule with a debtor, an auditor assessing a taxpayer, or a customs inspector conducting a search of an inbound traveller, each has to use judgment and discretion.

15.16 We supplemented our analysis of reported incidents with information on employees’ perceptions of the kinds of vulnerability the Department faces and the precautions it takes to deal with this vulnerability. This information was drawn from face-to-face interviews with 174 employees who were selected as a purposive sample from different hierarchical levels, operational functions, and geographic regions within Revenue Canada. The kinds of vulnerability that employees noted were very similar to those found in our analysis of reported incidents. Sixty-two percent of the employees we interviewed felt that the precautions the Department takes to deal with the identified vulnerabilities are excellent, or very good. Another 28 percent felt the precautions were adequate.

15.17 Risk management is an integral part of good management practice. It involves identifying, assessing and addressing risks or vulnerabilities to which an organization is exposed. Although Revenue Canada’s managers apply elements of risk management, the Department acknowledges that the process needs to be more formalized. It now has a draft risk management policy that addresses all sources of risk, both internal and external to the Department, including ethical risks. To convey its requirement for formalized risk management, the Department has conducted a number of workshops and is pilot-testing a training course.

Incidents of Misconduct

15.18 We have discussed some of the ways Revenue Canada is vulnerable to employee misconduct. While the Department has internal control systems to guard against the occurrence of abuse, it is not realistic to expect that incidents of misconduct can be entirely eliminated in an organization of Revenue Canada’s size and with its lines of business. Incidents of misconduct can and do happen in any region and at any hierarchical level within Revenue Canada. This means that all parts of the Department must have the means to deal with incidents, which entails first becoming aware that they have happened. Only then can the Department investigate the incident, discipline the offender, and take steps to prevent similar incidents. Exhibit 15.3 provides an overview of the processes for handling incidents, from reporting to final discipline.

Exhibit 15.3 is not available, see the Report.

Incidents of misconduct are reported

15.19 We found that a wide range of people have detected and reported incidents. While almost a third of the incidents we reviewed had been reported by people outside the Department, managers and other departmental employees had reported the other two thirds. Two factors encourage people to report incidents of misconduct: first, they have information on what and to whom to report; and second, their working environment is supportive of such reporting.

15.20 The Revenue Canada employees we interviewed knew that they should report incidents of misconduct. When we asked what steps they are expected to take upon learning of an incident, almost 75 percent of them stated that they should notify management or a supervisor. The next most frequent response (17 percent) was that employees should report the incident to security. These are, indeed, the courses of action recommended by the Department's security booklet.

15.21 The extent to which an organization supports the reporting of rule violations is an important indicator of both its commitment to its own rules and its credibility in the eyes of its own employees. Seventy percent of the departmental employees we interviewed felt that their work environment was very supportive of the reporting of infractions, and another 20 percent stated that it was somewhat supportive.

The Department investigates misconduct

15.22 Once an incident of potential misconduct has been reported, the Department investigates to determine whether misconduct has actually occurred and whether the offenders can be identified with certainty (Exhibit 15.4). Revenue Canada's central investigative body is its Security Directorate at head office. Through discussion, the Directorate and local management determine who should investigate a given incident. Depending on the nature of the incident and the expertise required, this could be the Security Directorate, local management or the appropriate police authority. The Directorate had conducted the investigation in almost 60 percent of the incidents we reviewed. Thefts of money must be reported to the local police and bribery cases turned over to the RCMP; harassment cases may be handled by local management.

Exhibit 15.4

Example of an Alert Revenue Canada Employee

Alert to misconduct of an employee in another office

In one case, an alert officer handling the Department's inquiry line reported a suspicious comment made by a caller. The caller, who had a tax preparation business, had contacted Revenue Canada with a routine inquiry. The individual stated that he knew there were errors in tax returns he had submitted and that he wanted an explanation. The caller said he had learned of the errors from a Revenue Canada employee with whom he was acquainted. The officer suspected that the caller's acquaintance had acted inappropriately in giving out the information and referred the matter for investigation. The investigation revealed that the Revenue Canada employee had indeed violated departmental regulations by accessing taxpayer information and disclosing it to an acquaintance.

15.23 Incidents are supposed to be reported immediately by local management to the Security Directorate. The Directorate requires up-to-date information to enable it to brief departmental senior management each week on all security incidents. Despite a requirement that incidents are to be reported immediately, in 68 percent of the cases we reviewed, the Security Directorate had not been notified of the incident within three days of its occurrence. As might be expected, the seriousness of the incident seemed to be a factor in determining how quickly incidents were reported: the Directorate was immediately notified more often about the most serious incidents.

15.24 In fact, it was primarily the most serious infractions that were brought to the attention of the Security Directorate. There is a tendency to resolve many infractions at a local level or informally, rather than to report them at the outset to the Security Directorate. This is the tendency in other organizations as well. Most organizations tend to experience many more minor rule violations than major ones.

15.25 Regardless of who undertook the investigation in Revenue Canada, we found that they started their investigation of incidents relatively quickly. Close to two thirds of the investigations we reviewed began within seven days of the incident's discovery; one third of investigations were started within one day. The duration of the investigations by Revenue Canada ranged from one day (mostly for thefts turned over to the local police) to about 9 months. Most are completed within 60 days.

Misconduct results in discipline and other corrective action

15.26 On completion of an investigation, the investigator reports to the manager of the location in which the incident occurred, who then determines what disciplinary action, if any, is appropriate. Discipline may serve either or both of two purposes. For the most part, it is meant to deter both the offender and other employees from like misconduct in the future. However, in rare circumstances it is meant to impose a penalty on the offender for specific misconduct. Its success can be judged only by how well it achieves both purposes.

15.27 In Revenue Canada, an offender's delegated manager in consultation with a staff relations advisor and, if appropriate, other departmental officials determine the disciplinary action for a specific incident. Departmental guidance reveals the general principle that the more serious the misconduct, the more severe the discipline (see Exhibit 15.5). We found that the severity of discipline tended to increase with the gravity of the incident. However, it was a weak pattern. In part this is because the Department takes into account a number of factors in determining what discipline is appropriate, such as the nature and seriousness of the misconduct itself and the past history of the individual involved.

Exhibit 15.5 is not available, see the Report.

15.28 Employees have the right to grieve disciplinary actions applied against them. The grievance process has four potential steps within the Department. Should employees still be dissatisfied with a disciplinary decision involving suspension, dismissal or financial penalty, they may go outside the Department for an adjudication hearing.

15.29 Grievances were heard in 40 percent of the cases we reviewed in which disciplinary action had been imposed. Over 85 percent of grievances went to the final level in the Department or to adjudication.

15.30 It is interesting that of the cases we reviewed, those involving the most serious infractions tended to move along more quickly in the reporting and investigation stages than did those involving lower-level offences, but tended to slow down considerably in the disciplinary and grievance stages. There appears to be a relationship between the seriousness of the offence and the time it takes to impose a final disciplinary action. In part this is because more serious cases are more likely than less serious cases to be grieved.

15.31 Discipline is not the final action that the Department needs to take as a result of misconduct. It needs to correct any weaknesses highlighted by an incident in order to prevent similar incidents. These could be weaknesses in systems and procedural controls or in information and training provided to staff.

15.32 We studied incidents of misconduct in which there were indications of weaknesses requiring attention, to determine what action management had taken. In most cases we reviewed, management had acted to correct observed weaknesses. On the whole, its responses were appropriate.

15.33 The preceding paragraphs demonstrate that Revenue Canada reacts in a determined and responsible manner to serious incidents of misconduct. We are not aware of any serious incidents for which the Department failed to arrange for an investigation, to impose disciplinary action, or to initiate action to correct any control deficiencies that had contributed to an incident's occurrence. While we did note certain areas for improvement (see paragraphs 15.54 to 15.87), we do not wish to undervalue the sound practices that are currently in place.

15.34 We wanted to discuss early in this chapter the Department's experience with incidents of misconduct for two reasons. First, by doing so we illustrate the nature and range of incidents to which Revenue Canada is vulnerable. Second, we feel that this discussion reveals much about Revenue Canada's attitude toward employee misconduct. Having set the stage, the chapter will now look at some of the things the Department does to promote the prevention and detection of employee misconduct.

Promoting an Ethical Culture

15.35 We have noted that Revenue Canada is vulnerable to employee misconduct and that incidents do occur despite internal control systems. Internal controls are only one element in the overall control regime. The other element involves motivating people to act with integrity even when opportunities exist for misconduct. A strong ethical culture within an organization provides such motivation for employees.

15.36 The modern trend in organizations is to make deliberate choices about the kind of culture they want to nurture, and to use vision, mission and values statements, in part, to convey information about that culture. We looked at Revenue Canada's revised vision, mission and values statements to see if they appeared to promote an ethical culture, and we found that they did. The opening sentence of the Department's vision statement reads: "Revenue Canada will be recognized and respected by clients for its integrity, fairness, and innovation in administering high-quality, yet affordable programs." Further, Revenue Canada's stated values include integrity, professionalism, respect and co-operation (Exhibit 15.6).

Exhibit 15.6

Revenue Canada's Values

Our values include integrity, professionalism, respect, and co-operation.

Integrity

is the cornerstone of our administration and it means treating people fairly and applying the law fairly. Integrity requires that we act with honesty and openness.

Professionalism

is the key to success in achieving our mission and it means being committed to the highest standards of achievement. Professionalism requires that we act with dedication and skill.

Respect

is the basis for our dealings with colleagues and clients and it means being sensitive and responsive to the rights of individuals. Respect requires that we act with courtesy and consideration at all times.

Co-operation

is the foundation for meeting the challenges of the future and it means building partnerships and working together toward common goals. Co-operation requires that we act with leadership and innovation.

15.37 The Department's mission, vision and values statements compare favourably with similar statements put out by private sector organizations. Together, they form a strong foundation for ethical conduct. Some improvements are still possible. For example, the vision statement could give greater recognition to the interests of employees, as it has to the interests of clients and government.

15.38 These important statements were in departmental planning documents, the latest version of which was distributed to employees during the summer of 1997. Managers received the strategic plan containing the full mission, vision and values statements, while other employees received a pamphlet with the mission, values and a condensed vision statement.

Leadership is key in promoting an ethical culture

15.39 Publishing and distributing statements of vision, mission and values are important, but are only a part of what is needed to instil an ethical culture in an organization. Employees look to senior management to determine whether these statements are really expected to guide conduct or whether they are just empty rhetoric. A stated and

visible commitment by senior management is essential to establish and maintain an ethical culture. Openness is one sign of management's commitment.

15.40 Lower-level managers whom we interviewed in offices across the country often noted that their senior managers operate with openness. However, a recent joint union-management survey of auditors suggests that managers and employees do not share a common view of the degree of openness displayed in the Department. In their answers to the survey questionnaire, fewer than 25 percent of the auditors described the current culture of Revenue Canada as open.

15.41 The involvement of employees at all levels in the Department — those on the front line as well as those in the boardroom — is needed to create an ethical culture. Revenue Canada's senior management encourages managers to discuss issues with their employees. For example, senior management asked local managers to make use of National Public Service Week and the distribution of the harassment policy to discuss issues with the staff. In addition, there were local activities. We heard about "town hall" meetings to distribute information to employees and to discuss departmental initiatives. One office had formed an employee-management team to promote a professional workplace environment.

Information provided to staff

15.42 In addition to the mission, vision and values statements, Revenue Canada revised three key booklets that convey to employees its expectations for their conduct. The revised booklets on standards of conduct, conflict of interest and security were distributed to employees in 1995. All employees need their own copies to facilitate their understanding, provide ease of reference, and enhance acceptance of the documents' provisions. The great majority of the employees we interviewed had received copies of the documents.

15.43 Finding other opportunities to repeat the messages contained in written codes of conduct reinforces management's efforts to promote an ethical culture. Over three quarters of the employees we interviewed reported that they receive information on employee conduct from departmental sources such as memos, directives, and team meetings. Managers and supervisors were more likely than front-line staff to receive such information.

Ethics training

15.44 Employees need to know what is expected of them and what the consequences will be if the rules are not followed. Providing them with written information and expecting that they will read and understand it is not a sufficient strategy on its own. Employees receive so much information that they may not have time to read and understand it during the course of their normal working day. Training that takes place away from the regular work setting and allows employees time to concentrate on the information being conveyed is a vital supplementary strategy. Aside from conveying needed information, providing formal training courses conveys a sense of the importance and seriousness that management attaches to the issues being covered.

15.45 Over 85 percent of the employees we interviewed said they had received some formal training at some point in their career on the subject of expected behaviour.

15.46 The arrival of new employees also provides the Department with an opportunity to convey its values and standards of conduct through training. Although there is no department-wide orientation course for new employees, two of the three business lines we reviewed have their own courses. Orientation training is part of both the in-residence training program for new customs inspectors and the technical training program delivered locally to new auditors.

15.47 After the orientation period has passed, training focusses on what employees need to know to do their jobs. Technical training for employees emphasizes how to apply legislation and use standard operating procedures, but it also covers some aspects of standards of conduct and values. Common subjects that are addressed in technical courses are the rules regarding confidentiality of client information and standards of professionalism to be applied in dealing with clients. Managers who participate in formal training also have an opportunity to reinforce commitment to the departmental values by relating their past experiences.

15.48 An important part of a manager's job is making decisions, and the training that managers receive reflects this reality. Values-oriented training is being emphasized with the aim that managers will apply the Department's values implicitly in their decision making. To this end, Revenue Canada's strategic plan is reviewed in the first-line managers' course and forms the basis for discussion during the middle-management orientation program.

15.49 About 65 percent of employees we interviewed rated the ethics-related training that they had received as excellent or very good. Another 27 percent rated the training as adequate. For them, it is important that courses be clear and relevant to their tasks, provide concrete examples that define misconduct, and spell out the consequences for potential offenders.

15.50 Formal training is not the only way that Revenue Canada's management nurtures its ethical culture and conveys the standards of conduct it expects. Through communication and example, Revenue Canada's senior managers encourage other employees to act with integrity. Managers who serve as role models for proper conduct during on-the-job training demonstrate the Department's ethical culture in action. Exposure to such examples is an integral part of absorbing a new employee into the work environment.

Staffing practices

15.51 One might expect that it would be easier to maintain an ethical environment if an organization hired only employees having the highest moral character. Precautions can be taken, but guarantees are not possible.

15.52 Compared with other government departments, Revenue Canada hires a great many new employees. It has an opportunity in the hiring process to assess the character of potential employees. The opportunity occurs in the process of interviewing and performing checks on candidates selected as potential employees. The extent of these reliability checks depends on the security classification of the job. For the majority of Revenue Canada's positions, the checks include looking for any past criminal record.

15.53 In its letters of offer, Revenue Canada includes a paragraph outlining the requirement for new employees to certify their understanding of and adherence to the conflict-of-interest code described in the booklet attached to the letter. However, neither the standards of conduct nor the security booklets are mentioned in the letter of offer. Whereas adherence to the conflict-of-interest requirements is a continuing condition of employment, the broader concept of meeting acceptable standards of conduct is not.

Areas for Improvement

15.54 We have described various elements of the framework that Revenue Canada employs to promote integrity among its employees. The investigation of potential incidents of misconduct, the imposition of discipline, and the correction of control deficiencies are three key elements. Other elements include the publication of mission, vision and values statements and the three key booklets on conduct that seek to describe the kind of organizational culture that Revenue Canada wishes to nurture. These publications are supported by training that reinforces some of the main messages and by an environment that is regarded by 70 percent of the employees we interviewed as conducive to the reporting of observed instances of potential misconduct.

15.55 All of these elements, taken together, form an important foundation for the promotion of integrity in Revenue Canada. Still, we find that promoting ethical behaviour is a preoccupation of a great many organizations and that there is a wide body of knowledge that could be drawn upon to further strengthen Revenue Canada’s foundation. Because of the vulnerabilities it faces, as revealed by the incidents of misconduct that it has experienced, Revenue Canada needs to always remain open and receptive to ideas that will help it to reinforce the framework that is now in place. This section describes certain areas for improvement that came to our attention.

There are some impediments to reporting incidents of misconduct

15.56 Two possible reasons come readily to mind that explain why people may not report incidents of misconduct to appropriate authorities: first, they may lack information on what and to whom to report; and second, their working environment may not be supportive of such reporting.

15.57 What to report to whom. While employees we interviewed know that they should report misconduct to their managers, managers we spoke to generally are not clear on what type of incidents to report to the Security Directorate. While some managers felt that all cases had to be reported, others indicated that it would depend on the nature and seriousness of the incident. According to departmental policy, managers are to report incidents of employee misconduct to the Directorate. However, managers often considered employee misconduct to be a staff relations issue that ought to be handled by them and not by security. In view of this confusion, the Department currently is clarifying its policy on the reporting of employee misconduct to the Security Directorate.

15.58 The booklets on standards of conduct, conflict of interest and security lack information on whom employees can contact for advice on how to apply the policies the booklets describe. Without any other information, presumably employees would contact their supervisors. While this would be an acceptable course of action in most cases, employees may hesitate to ask questions that concern their supervisors’ judgment. At such times it would be beneficial to have an individual who could be consulted on a confidential basis. Some organizations have created the position of “ethics advisor” to handle, among other things, inquiries of this type. An ethics advisor can also act as an intermediary between an employee who wishes to report an incident anonymously and the organizational unit that investigates incidents. Providing such protection to employees helps to remove impediments to reporting, because it assures employees that there will be no negative repercussions on them as a consequence of reporting an incident. Six of the 54 employees we interviewed who had suggestions to improve the reporting of incidents said they would want assurance that reporting would carry no repercussions (Exhibit 15.7).

Exhibit 15.7

Measures Suggested by Employees to Improve Reporting of Incidents of Misconduct

- Improve training on what is unacceptable conduct.
- Actively encourage reporting of misconduct.
- Clarify the reporting process.
- Identify “neutral” persons, instead of supervisors, to whom employees can report anonymously.
- Assure employees that there will be no repercussions for reporting infractions.
- Undertake investigations of alleged misconduct discreetly.
- Disclose more information on decisions taken in previous cases of misconduct.

15.59 An environment that supports reporting. Ninety–one percent of the managers we interviewed regarded the work environment as very supportive of the reporting of infractions; however, only 59 percent of front–line staff

we interviewed shared this view of the work environment. It is somewhat troubling that the front-line staff we interviewed perceived their environment as less supportive of incident reporting, because it is front-line staff who may be in a better position to observe misconduct as it occurs. We noted two situations in which misconduct had continued unchecked for over 11 months before someone eventually reported it to management.

15.60 A number of factors can contribute to employees' reluctance to report incidents of misconduct. One factor is the inherent desire to trust their colleagues. Employees can be very reluctant to make allegations about a co-worker unless they are reasonably confident that the allegations are well founded. This reluctance could be greater if their supervisors or co-workers are also aware of the misconduct but have not reported it. While it is not desirable to have a system that disciplines someone on the basis of an unfounded allegation, neither is it desirable to have a system that fails to hold to account those who commit improper acts. What is needed is a system that encourages the reporting of suspected misconduct, and follows up on reports with an investigation that respects the rights of the alleged perpetrators.

15.61 Another factor that could deter reporting is the perception that management will fail to act on reported misconduct. Employees interviewed in a recent internal audit expressed concern about the negative impact on morale when appropriate action is not taken to correct unacceptable behaviour of colleagues, including supervisors. One way to assure front-line staff that senior management does act on reported misconduct is to tell them what action has been taken. The Department could periodically distribute a report that summarizes the disciplinary measures it has taken.

15.62 Revenue Canada should study the merits of creating the position of ethics advisor, whom all departmental employees could consult on questions of values and conduct.

Department's response: In the context of the move to Agency status, Revenue Canada will consider the merits of creating a position of ethics advisor.

Application of discipline

15.63 To apply discipline fairly and consistently, managers need to know the Department's discipline policy and to have information on the discipline imposed for past incidents. The departmental guidelines on discipline date from before the administrative consolidation of Revenue Canada and are currently being revised. Revenue Canada does not have a data base on disciplinary actions it has imposed. While staff relations advisors have access to a data base of government-wide cases that were decided by adjudication, not all types of incidents necessarily go to adjudication. We were told that local staff relations advisors do not normally discuss incidents or discipline with colleagues in other Revenue Canada offices except those in the head office Human Resources Branch. Managers must rely for their information on the experience and memory of their staff relations advisors.

15.64 Dealing with individual cases is only part of the process of managing the Department's discipline and grievance programs. For the Human Resources Branch, another part is managing the programs at a strategic level. Variation exists in the disciplinary action for similar misconduct in the Department. Without a data base on disciplinary action, the Department cannot analyze trends in discipline decisions. With no trend analysis and little sharing of information, the Department is hindered in its efforts to ensure fair and consistent application of discipline. A recent internal audit recommended that staff relations advisors and managers be made aware of the disciplinary action being imposed in other offices. As a result, Revenue Canada is planning to capture information on all disciplinary actions, to analyze it and to report to senior management. For its analysis, the Department would need to capture the mitigating factors to understand why this variation in discipline exists for apparently similar misconduct.

15.65 As shown in Exhibit 15.8, we found that in 23 of 42 cases we reviewed with no grievances, final disciplinary action was imposed within 30 days of the completion of the investigation of an incident of misconduct.

In a further 16 cases, final disciplinary action was imposed within 31 days to 6 months, leaving 3 cases in which it took from 6 months to 2 years for final discipline to be imposed. Researchers in the criminal justice field have learned that harsh penalties have a limited deterrent effect due to the lower probability that they will be imposed. In contrast, even relatively mild penalties imposed promptly and with certainty have a greater deterrent effect.

Exhibit 15.8

Time Elapsed Between Completion of an Investigation and Imposition of Final Discipline

(Number of cases)

	Final Discipline - Cases Without Grievance	Final Discipline - Cases With Grievance	Cases Still Being Grieved at the End of Our Review
Up to 30 days	23		
31 days to 6 months	16	7	
6 months to 1 year	2	5	
1 year to 2 years	1	5	9
Over 2 years			5
TOTAL	42	17	14

Source: Revenue Canada

15.66 It is essential that the salutary effects of discipline be achieved while still protecting the rights to due process of employees found guilty of misconduct. It is for this reason that the grievance process exists. Where a grievance is involved, the average time to determination of final discipline is much longer, although a penalty will most likely have been served on the basis of the initial imposition of discipline. We reviewed 31 cases in which the initial discipline was grieved. Disciplinary action is often reduced following a grievance. For example, two times as many suspensions of more than 10 days were initially called for as were finally imposed.

15.67 Revenue Canada should study the discipline process to determine whether it is possible to increase the proportion of cases in which final discipline (or where a grievance occurs, initial discipline) is imposed within 30 days of the completion of the investigation of an incident of misconduct.

Department's response: Revenue Canada will study opportunities to maximize the proportion of cases where disciplinary action is taken within 30 days of the completion of an investigation into misconduct.

Corrective action is slow and narrowly focussed

15.68 We studied incidents of misconduct in which there were indications of weaknesses requiring attention, to determine what action management had taken in addition to any disciplinary action. While management's responses to rectify observed weaknesses were for the most part appropriate, at times the responses were very slow. For example, in the 1994 case of a major refund fraud by an employee, Revenue Canada has taken some action in the most critical areas of identified weakness but the work is not yet complete.

15.69 In the population of incidents we examined, a factor frequently contributing to the occurrence of incidents was a lack of prevention on the part of Revenue Canada — poor security, failure to follow standard procedures, and poor training. Lack of prevention had also been apparent in previous similar incidents, but additional measures had

not been taken to reduce the possibility of recurrence. In one case, the premises of other tenants of a building housing Revenue Canada offices had been broken into three times during a three-month period. No preventative action was taken until a break-in occurred at the Revenue Canada office itself.

15.70 Except for major incidents, there is no concerted effort by the Department to learn from incidents of misconduct that have national implications. Corrective action taken in one office is not conveyed to other offices to prevent similar incidents, even when the affected local office thinks there may be national implications. Providing information to other offices may alert managers there to potential weaknesses in their systems. Recently, the Security Directorate took a step that should help the Department deal with weaknesses highlighted by incidents. In its covering letters for investigation reports, the Directorate began including recommendations to correct weaknesses identified in specific incidents.

15.71 For those incidents that have significant national implications, Revenue Canada should ensure that remedial action is applied to all organizational units that are at risk.

Department's response: Revenue Canada concurs with this recommendation and continues to ensure that remedial actions on incidents that have significant national implications are applied to all affected departmental areas. Cases of misconduct involving financial administration that are reported to the Security Directorate are subsequently provided to the Financial Administration Directorate. In the Financial Administration Directorate, the cases are always reviewed and analyzed. When it is deemed that they have national implications or when it is deemed that a reminder/reinforcement is the appropriate response, financial policies, procedures or guidelines are prepared in the timeliest manner possible. These are disseminated in the form of electronic messages or by memorandum to all Regional Financial Advisors or in the form of a Financial Administration Bulletin to all Revenue Canada offices.

The Department does not monitor staff knowledge of expected conduct

15.72 Providing information and training to employees does not guarantee that they will understand and do what is expected of them. Employees' lack of understanding of departmental values and standards of conduct increases the risk of their misconduct. Management, therefore, needs to know the extent of employees' understanding in order to adjust, as appropriate, the Department's formal controls, information dissemination and training.

15.73 Revenue Canada's managers believe that employees understand what kinds of conduct are acceptable. However, many of the employees who were asked during an internal audit indicated that they were not fully aware of the Department's expectations or the consequences of misconduct. Aside from the internal audit, the Department has taken few steps to determine the level of employees' understanding of standards of conduct.

15.74 Surveys are one way to learn about the knowledge and attitude of employees regarding standards of conduct. Revenue Canada has undertaken few surveys of its employees, however, and none have dealt with the standards of conduct.

15.75 As part of this audit, we asked managers and other employees three questions about information contained in the booklets on standards of conduct, conflict of interest and security. The first question asked what employees should do upon learning about a security incident. Almost 92 percent of those we interviewed stated that they would notify their manager or security — the correct response. The second question asked about the disclosure of client information. The employees we interviewed tended to be more hesitant about disclosing information than they could be under the law. The third question asked whether departmental employees were treated the same as others who deal with the Department as private individuals. Over 90 percent responded correctly that treatment was the same. While our three questions do not constitute a definitive assessment of the knowledge of departmental employees, they do suggest that more study in this area could provide useful information. The responses to the first and third questions show that a noteworthy minority of employees are unclear about some fundamental rules. Responses to

the second question suggest that most employees may be unduly cautious about disclosing information, and this may be preventing these employees from responding to queries as fully as the Department would like.

15.76 Revenue Canada should monitor employee knowledge of the Department's expectations for conduct, through the use of staff surveys or other suitable means.

Department's response: In the context of the move to Agency status, Revenue Canada will consider various means to monitor employee knowledge of departmental expectations for conduct.

Information for staff needs improvement

15.77 Information is important not only in permitting the Department to correct systemic weaknesses but also in conveying the Department's expectations to individual employees. Organizational codes of ethics generally endeavour to encourage ethical behaviour by communicating values and guiding principles that employees are to practise in their daily work. The Department's booklet on standards of conduct is more like a code of ethics than the other booklets, although the conflict-of-interest and security booklets and several other related documents also contain information that could be included in a code.

15.78 Each employee is responsible for acquiring a working knowledge of the information contained in these sources. This is a lot of material for employees to learn in depth. We feel that a brief, easy to understand and easy to retrieve "code of ethics" document, highlighting the key information that employees need to know, would be a more effective means of communication. The material for this document could be extracted from the standards of conduct, conflict-of-interest and security booklets. This is an opportune time to note our concern, since Revenue Canada is currently updating the standards of conduct and security booklets and could easily add a new code of ethics to the initiative.

15.79 Our wish to see a code of ethics document is also rooted in concerns we have about how information is conveyed in the present booklet on standards of conduct. The opening message from the Deputy Minister could encourage ethical conduct more actively, along the lines of communications we have observed in private sector organizations. Further, the preamble that sets the stage for what follows could better reflect Revenue Canada's mission, vision and values statements. Making a link that demonstrates the consistency between these statements and the standards of conduct would heighten awareness of the importance of ethics.

15.80 Some of the language in the standards of conduct booklet is excessively legalistic, and this may hamper understanding. Moreover, the booklet focusses on what the standards of conduct are, with very limited discussion of why the standards exist. A statement of the standards unaccompanied by the underlying rationale does not give employees the same encouragement to adopt as their own the values and guiding principles that are the foundation of the standards. This can be critical, since in situations where the application of the standards is not clear-cut, a thorough grasp of the values and guiding principles will enhance the likelihood that an employee will choose the best course of action.

15.81 Leaving aside matters of content, we also have a concern relating to the distribution of the present set of booklets. Employees certify their understanding of the conflict-of-interest booklet, but only acknowledge the receipt of the booklet on standards of conduct. Because no acknowledgement of the security booklet is required, employees could conclude that the document is of low priority to management. Indeed, when we asked about the receipt of the three key booklets, fewer employees could recall receiving the security booklet than the other booklets. We believe that the distribution of all three booklets (and, in future, the code of ethics as well) needs to be controlled using procedures that reinforce the importance the Department places on them.

15.82 Revenue Canada should provide information on values and conduct to its employees in the form of a brief, easy to understand overview ethics document.

Department's response: In the context of the move to Agency status, Revenue Canada will examine the development of a briefer, easier to understand information document on ethics, values and conduct.

Ethics training is uneven

15.83 Providing employees with written information on expected conduct and expecting them to understand it is not a sufficient strategy on its own. This strategy needs to be supplemented by training.

15.84 There is now no course devoted exclusively to the subject of Revenue Canada's values and standards of conduct. To the extent that they are covered, it is during courses primarily devoted to some operational topic. About 85 percent of the employees we interviewed had received some formal training on ethics; however, the training coverage is uneven. In the orientation course for new customs officers, departmental values are specifically addressed. In contrast, the course for auditors had not been updated to include departmental values as such, though it did refer to concepts that correspond to them. Both courses cover the booklets on standards of conduct and security, but they stress different aspects. Neither course discusses the conflict-of-interest booklet; however, participants are asked to read it. As for the third business line we looked at, Revenue Canada had no national orientation training for new collectors at the time of our review, but some local offices had developed orientation courses. Subsequent to our review, the Department introduced an orientation course for new collectors. In addition, the Department is currently developing a department-wide orientation course for its employees.

15.85 The time when an employee first joins the Department is a logical point at which to provide training on standards of conduct. Another logical point is when the Department issues new standards. Revenue Canada could have provided training for all of its employees to coincide with the distribution of its three key booklets on conduct. We learned that a few local managers did hold information sessions when they distributed these booklets, but this was not part of a Department-wide initiative.

15.86 Employees we interviewed want training to occur on an ongoing basis in order to reinforce issues relating to standards of conduct. They need to be reminded of what is and is not acceptable conduct. Our analysis of incidents of misconduct supports the idea that reminders are needed. Over 40 percent of the offenders were veteran employees who should have known what conduct the Department expects of them. Although employees want refresher training, we found that the Department provides it only in the areas of harassment and security awareness.

15.87 **Revenue Canada should ensure that all new employees are given uniform training on departmental values and standards of conduct and that veteran employees are given uniform refresher training on departmental values and standards of conduct at appropriate intervals.**

Department's response: An introductory training course on conduct and values is already in place within the Department for new collections staff at Revenue Canada. The Department will examine the feasibility of expanding this course for presentation to all new staff. It will also examine potential mechanisms for updating veteran staff on these issues.

Conclusion

15.88 In this chapter we considered the various means that Revenue Canada uses to promote integrity among its employees. The Department investigates incidents of potential misconduct, imposes discipline, and corrects control deficiencies highlighted by incidents. In addition, Revenue Canada has published mission, vision and values statements and three key booklets on conduct that seek to describe the kind of culture that the Department wishes to nurture. These publications are supported by training that reinforces some of the main messages, and by an environment that is generally regarded by employees as supportive of the reporting of potential misconduct.

15.89 All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. However, because of the vulnerabilities it faces, as revealed by the incidents of misconduct that it has experienced, Revenue Canada needs to remain vigilant in promoting integrity.

15.90 There are certain areas for improvement that will help it to reinforce and build on the solid foundation that is now in place. Discipline is imposed for misconduct; however, the disciplinary process can be slow and this may diminish its effectiveness as a deterrent to similar misconduct. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than national weaknesses. Further, although information and training on values and conduct are provided to employees, the information is not presented optimally for ease of understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of values and conduct and the resulting impact on vulnerability to misconduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

About the Audit

Objectives

Our audit objectives were to determine whether the Department:

- communicates and promotes compliance with corporate values;
- monitors vulnerability to employee misconduct;
- identifies, investigates and reports incidents of misconduct;
- applies discipline against employees who are guilty of misconduct; and
- analyzes causes of incidents of misconduct or other indications of vulnerability and takes remedial action in response.

Strategy and Scope

The following diagram, a conceptual framework for total risk, helps explain our audit strategy. It shows three components of total risk: two are the components that reduce risk; the third is the residual risk to which the Department is exposed. The first component that reduces risk is internal controls and internal audit. Internal controls are the traditional methods and measures put into place by management to prevent and detect both error and employee misconduct. Internal audit provides the Department's management with an independent evaluation of certain aspects of its operations.

The second component that reduces risk is compliance with corporate values. Compliance with corporate values is not dictated in the same sense as is compliance with internal controls; rather, compliance comes about through management's actions to convince employees to comply and through the Department's operating as a "social unit".

Residual exposure to risk leaves some potential for incidents of employee misconduct to occur. When employee misconduct is identified, it is investigated and discipline is applied, as necessary. Feedback from the monitoring and analysis of incidents may result in corrective action on internal controls and in means to encourage compliance with corporate values.

We examined how Revenue Canada acts to reduce the risk of employee misconduct by encouraging compliance with corporate values, and the processes that result in corrective actions. The audit did not include a review of internal controls, since there is extensive coverage of them in our other audit work. The examination concentrated, at the operational level, on three business lines (collections, audit and customs) and on certain headquarters functions.

Approach

We performed a survey using a structured questionnaire, with responses gathered in face-to-face interviews. The purposive sample of 174 employees was selected to achieve representation according to a number of dimensions: (1) position — managers, supervisors and front-line staff; (2) business lines — audit, collections and customs; and (3) location — regions and headquarters. The questions asked in the survey dealt with five areas: information for employees; training; vulnerabilities to misconduct; reporting of incidents; and staff knowledge. In addition to the formal survey, we conducted many free-form interviews, mainly with managers.

We reviewed the documentation relating to all 285 incidents of potential employee misconduct reported to the headquarters Security Directorate from 1 January 1995 to 30 June 1996. We used a standardized data collection instrument to gather information in a manner that would facilitate subsequent analysis. This period was chosen because it was recent enough to ensure that all relevant information would still be on file (in accordance with the Department's records-retention policy) yet old enough that a significant number of cases would have progressed to their final outcomes.

We compared the content of several key departmental publications/documents related to the subject matter of the audit with those of private sector organizations. These were the mission, vision and values statements and the standards of conduct, conflict-of-interest and security booklets/handbooks. We also examined the training materials related to several in-house courses delivered to employees involved in the audit, collections and customs business lines, to determine the extent to which they contained material relevant to the subject matter of our audit.

In addition to the major sources cited above, we reviewed information contained in various other documents and data bases.

The examination phase of this audit was conducted as a collaborative effort between the Office of the Auditor General and the Internal Audit Service Division of Revenue Canada.

Criteria

We expected to find:

- a stated and visible commitment by senior management to establish and maintain accepted standards of conduct and performance in the Department.
- clear procedures and guidelines mandating and explaining accepted practices and expected conduct and discipline for misconduct, communicated to all employees and updated based on the evaluation of results and experience.
- clear and specific assignment of responsibilities for the prevention, detection and investigation of potential or suspected incidents of breaches in controls and compliance.
- vulnerability assessments conducted by managers to identify, document and prioritize compliance and control risks associated with their areas of responsibility.

- investigation and adequate documentation of potential incidents of non-compliance and of breakdown of controls, followed by appropriate corrective action and disciplinary measures, if needed.
- a comprehensive and reliable reporting system to inform senior management and, as necessary, its staff about the actions taken following incidents and the lessons learned.

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Chapter 16

Management of the Social Insurance Number

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Management of the Social Insurance Number

Main Points

16.1 The Social Insurance Number (SIN) was implemented in 1964, to provide Unemployment Insurance, Canada Pension Plan and Quebec Pension Plan clients with a file number. In 1967, it also became a file identifier for Revenue Canada. From the outset, the SIN was the subject of intense parliamentary interest and debate. The controversy focussed largely on the implications of a potential expansion of its use to become a universal identifier. The history of the SIN has mainly reflected the tension between balancing the often competing objectives of maintaining individual privacy and improving administrative efficiency and effectiveness.

16.2 Human Resources Development Canada has been administering the SIN in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs. However, the public often perceives the SIN to be a personal identifier or even an identity card.

16.3 The use of the SIN outside the federal domain has evolved beyond the intent of the Treasury Board policy established in 1989, aimed at preventing it from becoming a national personal identifier. Our audit found that the SIN has become the common numerical identifier both inside and outside the federal government for a wide range of income-related transactions and benefits, among other uses.

16.4 Changes to the *Income Tax Act* and Regulations have increased the use of the SIN at the provincial/territorial level and in the private sector, as have the growing number of data exchanges, comparisons and matches among various tiers of social programs.

16.5 However, the SIN has a number of weaknesses. Some of them are well known. As the use of the SIN has become more widespread, these weaknesses have grown in importance. They include the following:

- The information on SIN holders, particularly on births and deaths, is not always complete and accurate.
- Existing SIN application procedures are insufficient to guard against fraud and abuse. Holders of 11.8 million SINs who registered prior to the introduction of the proof-of-identity program in 1976 have not been asked to provide proof-of-identity documentation. This exacerbates the risk of misrepresentation.
- The provinces and financial institutions are required by the *Income Tax Act* and Regulations to collect SINs for tax purposes but cannot validate the SIN numbers provided by their clients.
- SIN errors, abuse, and misuse affect many federal programs, provinces and the private sector. Collectively, the impact may be sizable.
- Minimal effort is dedicated to investigations of SIN fraud and abuse, and penalties are minimal, with no real impact on deterrence.
- Unregulated use in the private sector, except in Quebec, makes it vulnerable to abuse in terms of both privacy and fraud.

Main Points (cont'd)

16.6 The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

16.7 There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized. In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness, and finding a satisfactory solution.

Introduction

The Social Insurance Number Was Created in 1964

16.8 When Prime Minister L. B. Pearson stood in the House of Commons in April 1964 to announce that the government intended to introduce the new Social Insurance Number (SIN), he may not have realized how deeply he was affecting the way Canadian social programs would be administered in the years to come. At the time, the need to introduce the SIN was twofold. First, the Unemployment Insurance registration system was running out of numerical combinations to identify its clients. Second, the new Canada and Quebec Pension Plans would require a national system to register and identify contributors and recipients.

16.9 In the early sixties, the Royal Commission on Government Organization (also known as the Glassco Commission) concluded that “a numbering system that could be used to identify individuals for all purposes would contribute significantly to improved efficiency, both in government and outside.” In response, there were several interdepartmental discussions about using the SIN as a common identifier to achieve savings and avoid the confusion that could arise if various departments used their own numbering schemes. The first name contemplated for the new number was the *Canada Account Number*, reflecting an intention to use it in all financial transactions between the government and individual citizens.

16.10 However, political pressures influenced the government of the day to restrict the use of an identifying number instead of expanding it. Thus the *Social Insurance Number* was born, and it was presented in the House of Commons as an initiative restricted to Unemployment Insurance and the Canada and Quebec Pension Plans.

The Role of the Social Insurance Number Has Expanded Gradually

16.11 Despite the emphatic statements made in the House of Commons in 1964, the federal government proceeded in the following years to incrementally expand the scope of the SIN. In 1967, the *Income Tax Act* was amended to authorize the use of the SIN on tax returns — a critical extension. In 1976, the *Income Tax Act* was amended again to require that individuals cashing Canada Savings Bonds provide their SIN. Insurance companies and financial institutions then started collecting their clients’ social insurance numbers for tax purposes.

16.12 As an array of data bases were created in the 1970s and 1980s to administer various government programs, the SIN was adopted instead of each time creating a new user number or client number. Today, over 20 federal statutes, regulations and programs authorize the use of the SIN (see Exhibit 16.1 for a detailed list). Its use expanded gradually to provincial social programs and, in the private sector, to the many companies that use the SIN to identify their employees and their clients. Some of these uses, which are unofficial, were not anticipated in the legislation and therefore are not explicitly or implicitly prohibited.

Exhibit 16.1

Authorized Uses of the Social Insurance Number (SIN)

Statutes and Regulations
1. <i>Budget Implementation Act</i> (Canada Education Savings Grants)
2. <i>Canada Elections Act</i>
3. Canada Labour Standards Regulations (Canada Labour Code)

4. Canada Pension Plan Regulations (Canada Pension Plan)
5. *Canada Student Financial Assistance Act*
6. Canada Student Loans Regulations (*Canada Student Loans Act*)
7. *Canadian Wheat Board Act*
8. *Employment Insurance Act*
9. *Excise Tax Act* (Part IX)
10. Garnishment Regulations (*Family Orders and Agreements Enforcement Assistance Act*)
11. *Farm Income Protection Act*
12. Gasoline and Aviation Gasoline Excise Tax Application Regulations (*Excise Tax Act*)
13. *Income Tax Act*
14. *Labour Adjustment Benefits Act*
15. Old Age Security Regulations (*Old Age Security Act*)
16. Tax Rebate Discounting Regulations (*Tax Rebate Discounting Act*)
17. Veterans Allowance Regulations (*War Veterans Allowance Act*)

Programs

1. Income and Health Care Programs (Veterans Affairs Canada)
2. Immigration Adjustment Assistance Program (Citizenship and Immigration Canada)
3. Labour Adjustment Review Board (Human Resources Development Canada)
4. National Dose Registry for Occupational Exposures to Radiation (Health Canada)
5. Rural and Native Housing Program (Canada Mortgage and Housing Corporation)
6. Social Assistance and Economic Development Program (Indian and Northern Affairs Canada)
7. Income Tax Appeals and Adverse Decisions (Revenue Canada)

Source: Department of Justice and Treasury Board Secretariat, June 1998

16.20 Further details on the audit objectives, scope and criteria are presented at the end of the chapter, in the section entitled **About the Audit**.

16.13 The increasing use of the SIN has growing implications for program integrity and privacy protection. It is used by many federal and provincial government departments as one of the key tools in managing the programs that require precise identification of payers, claimants or recipients. It is used as an identification number to verify benefit entitlement, to collect and add information to clients' files and to match and exchange data among programs. Generally, people must have a SIN to work and to collect Employment Insurance benefits, Canada Pension Plan payments, and tax refunds, benefits and credits.

16.14 It is critical to link the SIN with its rightful owner. When this linkage does not occur, payments of benefits, pensions and credits and collection of income tax could be in error.

16.15 Each SIN number entails collecting birth, name change and death data, along with citizenship status, which can act as an additional cross-check in determining identity and eligibility for programs. Accurate information in the SIN data base is important for both service and control.

16.16 The SIN has obvious potential as a tool for facilitating the joint delivery of services in income security programs, given its now widespread use as a client identifier in such programs. Both Human Resources

Development Canada (HRDC) and the Treasury Board have considered using the SIN as one means to streamline service delivery.

16.17 The widespread use of the SIN considerably increases its potential for fraud and abuse, as well as the variety and extent of the illegal activities to which it gives rise. Exhibit 16.2 shows how diverse and pervasive abuses of SIN can be. The cost to the government and to society in general could be significant.

Exhibit 16.2

Types of SIN Abuse

Federal, Provincial and Municipal Social Programs

- Obtaining benefits from Canada Pension Plan, Quebec Pension Plan, Employment Insurance and social assistance using different names or while working under another identity.
- Using many identities to collect Old Age Security cheques.
- Fabricating a new identity and obtaining a student loan.
- Obtaining credit for grants or sales tax credits using different names.
- Obtaining many health cards.

Federal and Provincial Income Tax

- Splitting income or obtaining various tax credits by using several names.
- Using many identities to hide investment income.

Work Permits and Licenses

- Obtaining work permits using different names.
- Obtaining a replacement driver's license under a different identity.

Commercial Activities

- Obtaining many credit cards or many lines of credit using different names, and disappearing once the maximum credit limit on all of them has been reached.
- Securing loans in banks using faked identification and subsequently disappearing.
- Making term deposits using different names.
- Renting luxury cars with the intent of selling them in foreign countries and subsequently disappearing under a new identity.

Source: HRDC and Office of the Auditor General of Canada

Roles and Responsibilities Are Dispersed

16.18 In the federal government, the roles and responsibilities for the SIN are dispersed. HRDC is the custodian of the SIN: it is responsible for issuing SINs, maintaining the Social Insurance Register (SIR), investigating suspected abuse, and making regulations if necessary. The Treasury Board is responsible for the policy and guidelines that govern the collection and use of the SIN at the federal level, including data matching. The Office of

the Privacy Commissioner, an independent oversight agency, investigates complaints about the SIN, reviews compliance with the *Privacy Act* and reports to Parliament. The Department of Justice supports other departments in providing legal advice for SIN-related questions arising under the *Privacy Act*, and responds to general inquiries from the public on the private sector's use of the SIN.

Focus of the Audit

16.19 The objective of our audit was to assess the management and control of the SIN to determine if it is efficient and effective and has an appropriate basis in legislation. We examined the role and use of the SIN in managing social programs and revenue collection; the application process; the management of the SIR; and the investigation of fraud and abuse. In addition to examining activities at HRDC, we interviewed officials and reviewed relevant documentation at Revenue Canada, Citizenship and Immigration Canada, the Treasury Board Secretariat, Industry Canada, the Department of Justice, the Royal Canadian Mounted Police, the Office of the Privacy Commissioner, Elections Canada, the Canadian Passport Office and many provincial organizations. We performed extensive analyses of the SIN data base provided to our Office by HRDC. We also talked to privacy experts and other organizations with interests in the SIN.

Observations and Recommendations

Importance of the SIN

The SIN has become a de facto national identifier for income-related transactions, contrary to the government's intent

16.21 The federal government sought in 1988 to restrict use of the SIN in its programs by developing the current policy on the control and use of the SIN and data matching. This policy was developed in direct response to recommendations arising from the review of access to information and privacy legislation that was conducted in 1986 and 1987 by the Standing Committee on Justice and Solicitor General. The government clearly indicated that its intention was to prevent the use of the SIN as a national personal identifier in order to protect individual privacy. For instance, it limited the federal use of the SIN to the administration of tax, pension, social and benefits programs, along with programs authorized under a few federal statutes (such as the *Employment Insurance Act*).

16.22 For example, the federal government stopped using the SIN on citizenship forms. It eventually deleted the SIN from many data bases and stopped using it to identify its own employees. It indicated that any new uses in the federal government would require parliamentary approval. However, it did not address the growing use in the private sector and by the provinces, territories and municipalities. Nor did it anticipate the impact that amendments to the *Income Tax Act* and Regulations would have as they began to require a SIN for more types of financial transactions and benefits.

16.23 In 1992, the Income Tax Regulations were amended to require that provinces include the SIN on T5007 tax slips issued to all recipients of social assistance and workers' compensation payments. This virtually guaranteed the dominance of the SIN as the common program identifier for provincial and municipal social programs. With similar programs at the federal level (Employment Insurance, Old Age Security and Canada Pension Plan), together they constitute a cluster of programs representing close to \$100 billion in annual payments — 26 percent of all government expenditures in Canada.

16.24 The recently announced Canada Education Savings Grant will require that a new population (an estimated 1 million out of 7 million children) obtain a SIN in order to receive government grants, and to satisfy requirements

of the *Income Tax Act* and Regulations. Today, almost any transaction related to an income support payment or loan, revenue collection, and an individual's personal finances has a SIN attached to it. The growing importance of the SIN has shown little sign of abating, despite government intentions to the contrary.

A common numerical identifier is important in the growing number of data matches

16.25 Data matching is defined by the Treasury Board as the comparing or linking of personal information obtained from different sources for the purpose of making decisions that could affect the individuals to whom the information pertains. Data comparisons for other purposes such as research are not considered to be "data matches" under the Board's definition.

16.26 The growing use of data matching, comparison and exchange between and among jurisdictions in administering social programs has been greatly facilitated by the use of the SIN. Using a numerical identifier is often seen as the most practical and efficient way to match personal data, because of its uniqueness and universality. Other personal identifiers or any combination thereof could be used, such as date of birth, surname, name, gender and/or address. However, a recent study done by Elections Canada indicates that more than 10 percent of Canadians have the same family name and date of birth as at least one other Canadian. Also, people do not always report their names consistently, and names can be misspelled. Further, 16 percent of Canadians aged 18 or older move each year. Information can also be recorded in different file formats. All of these factors complicate data matching without a numerical identifier.

16.27 Most data matching in the federal government uses the SIN as the core personal identifier for matching information from two data bases. The Old Age Security (OAS) program showed the benefit of using the SIN. The difficulty of managing the files among programs such as the Canada Pension Plan (CPP), OAS, and International Agreements for OAS and of matching their data without a SIN led HRDC to launch an initiative to assign SINs to all beneficiaries. Provincial social services programs we visited also use the SIN extensively to validate client lists among their various jurisdictions. For them, having a common element like the SIN is important because of incompatibility among the different systems. Other identifiers such as health card numbers and driver's license numbers are unique, but are specific to each province. Thus, unlike the SIN, they cannot be used for interprovincial data matches or for matches between federal and provincial social programs such as Employment Insurance and social assistance.

16.28 Our review of current data matches at HRDC that use the SIN as a common identifier indicated that they achieve significant savings through avoidance of overpayments, recovery of overpayments and debts, and administrative efficiencies. For example, HRDC's Computer Post-Audit program matches employment insurance claims with records of employment information to identify persons who are collecting benefits but are not reporting or are underreporting their earnings. For fiscal year 1996-97, this data-matching activity alone generated about 570,000 investigations that identified overpayments of \$102 million and resulted in penalties totalling \$50 million.

Integrity of Data in the Social Insurance Register

The Social Insurance Register: 33 million SINs issued

16.29 The Social Insurance Register (SIR) is the register that records the personal information provided by individuals when they apply for a SIN. It contains all the SINs and key basic personal information such as dates and places of birth and death, and mother's and father's names. Certifying, registering, issuing and keeping track of millions of SINs is a complex task, undertaken on a very large scale. A total of more than 33 million SINs have been issued since 1964. National Services, a branch of HRDC that operates out of Bathurst, New Brunswick, manages the SIR and issues about one million cards (new and replacement) each year. Its annual operating costs are \$7 million, \$2 million of which is collected from applicants for replacement cards. The remaining \$5 million in costs is divided

among the original users of the SIN — Revenue Canada, CPP, the Quebec Pension Plan and the Employment Insurance Account — who share operational responsibility for the integrity of the data bank. Our audit work showed that the SIR is generally well protected and physically secure.

Significant gap between number of living SIN holders and size of the Canadian population

16.30 Stakeholders have raised concerns about the high number of living SIN holders in the SIR compared with the size of the Canadian population: a gap of about 3.8 million for those aged 20 or older, the age at which most Canadians have obtained a SIN (see Exhibit 16.3). Various factors could account for the gap: the number of Canadians and non-Canadians who have left the country, deceased SIN holders whose deaths have not been reported to HRDC, and SINs based on fraudulent identities. Since the gap cannot be reconciled with any certainty, it represents a risk of increased error, abuse and misuse of the SIN that could allow inappropriate access to federal and provincial programs.

Exhibit 16.3

Comparison of Social Insurance Register and Statistics Canada Data on the Number of Living Individuals Aged 20 or Older

Age	Social Insurance Register	Statistics Canada	Difference
	Number of SINs ¹	Actual Population ²	
20 – 29	4,258,017	4,237,481	20,536
30 – 39	5,541,599	5,270,366	271,233
40 – 49	5,466,430	4,649,732	816,698
50 – 59	4,093,556	3,176,758	916,798
60 – 69	2,746,661	2,351,296	395,365
70 – 79	2,091,465	1,729,139	362,326
80 – 89	1,084,768	728,261	356,507
90 and over	770,871	127,095	643,776
Total	26,053,367	22,270,128	3,783,239

Source : ¹ HRDC, Social Insurance Register, 31 March 1998

² Population estimates on 1 July 1997, according to Statistics Canada

16.31 Our audit work included analytical testing of the 33 million records, provided to us by HRDC. We found that the number of unrecorded deaths is one of the biggest factors in the gap. From 1965 to 1990, only 1 million deaths were registered in the SIN data base, far below the 4.4 million deaths in the Canadian population for the same period. Since 1993, SIR has obtained information about deaths using additional data from other sources such as CPP, Revenue Canada and the Régie de l'assurance-maladie du Québec (RAMQ). During the period 1991 to 1997, over 2.6 million deaths were registered in the SIN data base, a dramatic improvement (see Exhibit 16.4).

Exhibit 16.4 is not available, see the Report.

16.32 The collection of death data still needs to be improved, however. The number of living Canadians registered in the SIN data base in 1998 remains significantly higher than in Statistics Canada data. For example, the 1998 data base shows 771,000 persons aged 90 and older who have an active SIN, compared with the 127,000 individuals (less than one sixth) shown by Statistics Canada's data for this age group. More striking is the

comparison of 311,000 people aged 100 years or older who are considered to be still alive, according to the SIR, with only 3,000 recorded in Statistics Canada census data.

16.33 Without additional efforts to record deaths, the gaps will continue to grow, along with the potential for confusion and inefficiency and the risk that the identities of deceased individuals could be used for fraudulent activities. While other federal programs collect death data, they do so only for their target population and the data are not always complete. For instance, about a third of the approximately 3,000 frauds detected by Income Security Programs at HRDC since 1985-86 pertained to cheques negotiated after the eligible recipient's death.

Existing sources of information are not fully exploited and more could be done to develop new sources

16.34 In 1996, Revenue Canada provided death update files to SIR three times. In 1997, it was agreed that this information would be sent only once a year. The comparison between SIR and RAMQ data demonstrated that similar comparisons with other provincial health insurance programs, which are not undertaken at present, could potentially reveal hundreds of thousands of unreported deaths. Vital statistics bureaus in the provinces, territories and foreign jurisdictions are other potential sources of information. However, as most of them do not use the SIN, sharing data would be difficult.

16.35 Even though CPP, Revenue Canada and SIR are sharing more data, the problem of reconciling the various sources remains. For example, Revenue Canada does not provide SIR with corrections it makes to its taxpayer files when it notes discrepancies in date of birth, name, etc. Revenue Canada informed us that the income tax system and the various credits and benefits administered by Revenue Canada rely heavily on an individual's SIN but less on such items as date of birth or name. As a result, non-critical variations in those parts of an individual's data record are accepted with less verification than would be required by SIR.

Millions of SINs are not certified for identity

16.36 In 1976 a proof-of-identity program began that required applicants for a SIN to provide identification documents. As of March 1998, the Social Insurance Register contained 16.8 million SIN entries that had not been supported with identification documents. This represents 51 percent of SINs issued. However, some of the uncertified records do not need to be validated — where the individual is deceased or the SIN has been cancelled, voided, or validated by other programs. This leaves approximately 11.8 million uncertified accounts in the SIR that, because of the potential for error, misuse and abuse, should cause major concerns to those who make significant use of the SIN, such as Revenue Canada and all income security programs.

Birth-related information is not easily validated with the issuing organizations

16.37 Accurate birth information is as important as death information to the integrity of the SIN data base. SIR does not generally confirm the validity of information shown on documents accepted for SIN applications with the organizations that issued them. For example, SIR does not validate information on birth certificates (existence, date and place of birth, parents' names, or whether the individual is deceased) with information in provincial and territorial vital statistics registries.

16.38 The urgent need to resolve this issue is highlighted by comparisons we made between OAS and SIR data bases and between CPP and SIR data bases. These comparisons were performed in 1998 and showed discrepancies of four to five percent in their birth data. The gap in the date of birth between SIR and OAS/ CPP data bases is 22 months on average, with a maximum of 50 years. These discrepancies affect 166,000 OAS files and 98,000 CPP files.

16.39 The difficulty of validating birth-related data with vital statistics is well known and long-standing. HRDC is currently conducting a pilot project with the New Brunswick government that allows on-line verification of birth and name change information provided by SIN applicants. The SIN applicant's information is also verified on-line with the province's death registry to ensure that the individual has not been reported deceased. Extending this project to other provinces and territories could enhance the reliability of the SIN data base, although privacy implications would need to be assessed. As well, provinces, territories and the federal government may not yet be technologically compatible.

16.40 Applications based on Citizenship and Immigration Canada documentation for new SINs, replacement cards and status changes represent one third of SIR annual workload. SIR now has an on-line connection with Citizenship and Immigration Canada's information system. Data in the system can be accessed quickly to validate the information provided by applicants.

16.41 By validating the information on birth certificates and other documents with the organizations that issued them, SIR could eliminate errors in the information it registers on SIN holders. It could also reduce the risk of issuing SINs to impostors whose applications are supported by fraudulent or modified documents. Since the information contained in the SIR is considered personal, HRDC has a legal requirement to take all reasonable steps to ensure its reliability. Section 6(2) of the *Privacy Act* requires government institutions to ensure that personal information being used for an administrative purpose is as accurate, complete and up-to-date as possible. As noted earlier, HRDC has made some efforts in this direction. However, it does not have in place a comprehensive plan to ensure that SIR information meets this requirement.

16.42 **Human Resources Development Canada, in co-ordination with its partners, should ensure where appropriate that available information from federal and provincial programs is used effectively to improve the integrity of the Social Insurance Register.**

16.43 **Human Resources Development Canada should develop a comprehensive plan with appropriate targets and time frames and clear statements of roles and responsibilities to bring the reliability and completeness of the data in the Social Insurance Register to an appropriate level.**

Human Resources Development Canada's response: HRDC agrees with both recommendations. HRDC recognizes the importance of improving the integrity of the Social Insurance Register and will increase its efforts to work with other federal partners, the provinces and the territories to obtain the information required to achieve the desired level of integrity. HRDC will, in co-operation with its partners, develop an appropriate federal-provincial strategy and action plan. Even though they may want to provide personal information, the provinces and territories may need to amend their privacy legislation and may also have to make substantial system changes.

Valid SINs are held by thousands of individuals with no legal status in Canada

16.44 The SIR issues temporary SINs (900 series) to non-permanent residents such as refugee claimants, seasonal workers and foreign students, based on immigration documents that eventually expire. A 900-series SIN can also be issued to any citizen of another country, even if he does not reside in Canada, for such reasons as opening a bank account or investing in Canada. If those SIN holders obtain permanent residency in Canada, they are entitled to change their 900-series SIN for a regular SIN. The observed tendency is for people to request the regular SIN quickly after gaining permanent residency, since it is perceived as more valuable. Since 1976, when the 900 series began, 1,242,000 temporary SINs have been issued. In 1998, some 680,000 temporary SINs remain active and 66 percent of these are over five years old, a long period of time for a number considered temporary. The number of temporary SINs issued is 470,000 higher than the 210,000 non-permanent residents reported by Statistics Canada in 1997. Since the SIN has no expiry date, this difference could include SIN holders who have left Canada. If SIR has not been formally advised of a departure, there is a risk that the 900-series SIN with no expiry date could be given, rented or sold to another individual.

16.45 Alternatively, the gap could represent SIN holders who are residing here illegally. For example, a 1994 Revenue Canada estimate showed that thousands of individuals who were using their SIN to work or obtain social assistance or tax credits had no legal status in Canada, according to Citizenship and Immigration Canada's records. Out of 80,000 individuals with a 900-series SIN who collected Goods and Services Tax (GST) credits in January 1993, Revenue Canada estimated (based on a sample of about 3,600) that 32 percent could have received benefits to which they were not entitled. Revenue Canada estimated that the potential loss on GST credits could be as high as \$8.2 million. Revenue Canada also noted that the reported source of income of many of these individuals was social assistance. Therefore, losses by provincial and municipal governments could potentially have been substantial. We realize that this issue may be difficult to resolve because it could possibly involve reconciling mandates of departments involved as well as the confidentiality provisions of the *Income Tax Act* and the requirements of the *Privacy Act*.

16.46 Human Resources Development Canada, in conjunction with Revenue Canada and Citizenship and Immigration Canada, should address the risks associated with the issuance of temporary SINs that have no expiry date.

Human Resources Development Canada's response: Agreed. HRDC is establishing a working group mandated to address the risks associated with the issuing of temporary 900 series Social Insurance cards that have no expiry date. Citizenship and Immigration Canada and Revenue Canada have already indicated their willingness to participate.

Revenue Canada's response: Agreed. Revenue Canada will participate with Human Resources Development Canada and Citizenship and Immigration Canada, in a co-operative effort, to decrease the risks associated with the issuance and retention of temporary SINs, recognizing that there may be legislative constraints limiting the exchange of certain information in this exercise.

Citizenship and Immigration Canada's response: Agreed. Citizenship and Immigration Canada (CIC) has a number of working arrangements with Human Resources Development Canada and Revenue Canada (RC) to address issues of mutual concern, including the use of the SIN. CIC will renew its efforts, in conjunction with RC and HRDC, to address the risks associated with the lack of expiry date on temporary SINs.

Processing and Control of the SIN

More rigour needed in the proof-of-identity program

16.47 There are two ways of submitting an application for a SIN: in person at a local Human Resource Centre of Canada (HRCC) or by mail. The applications submitted to HRCCs are reviewed by agents who examine proof-of-identity documents, which are usually originals. The applications found to be in order are certified by agents and forwarded to National Services in Bathurst. Individuals can also mail SIN applications directly to Bathurst. There, direct mail applications are reviewed by SIR staff for accuracy and completeness, and the proof-of-identity documents (original or a certified copy) are examined. SIR operators review each application received from HRCCs and in the mail. If there are no internal inconsistencies or omissions, the application is accepted for processing.

16.48 Different kinds of documents are accepted as proof of identity, depending on the status of the person applying for a SIN card. Canadian citizens can provide a birth certificate issued in Canada or a citizenship card issued by Citizenship and Immigration Canada. Permanent residents must present their Record of Landing. Temporary residents must present immigration documents that authorize them to remain in Canada for a specified period of time.

16.49 Generally, the SIN application process asks for only one identity document and does not have other means to confirm identity. We compared SIN requirements with those of other HRDC programs as well as the Passport Office. We found that these other programs had additional controls to verify the identity of applicants (see Exhibit 16.5).

16.50 In general, mailed applications represent a somewhat greater risk than in-person applications, because certified photocopies are accepted — which themselves could have been certified fraudulently — and applicants who raise suspicion cannot be questioned. At present, mailed applications represent only 10 percent of the applications processed in Bathurst, one of the smallest mail intake ratios of the programs shown in Exhibit 16.5. We noted that the SIR compensates for the risks associated with mailed applications through its screening procedures as well as specialized tests and controls; this leads to a rejection rate of about 30 percent.

Exhibit 16.5

Comparison of Proof-of-Identity Requirements for a SIN Application and Selected Programs - 1998

	SIN	Canada Pension Plan	Old Age Security	Employment Insurance	Passport Office
One document to support identity (e.g. birth certificate)	Yes	Yes	Yes	Yes ¹	Yes
Additional document(s) or other means to support identity	No	Yes ²	Yes ³	Yes ⁴	Yes ⁵
Certified copy accepted	Yes	Yes	Yes	No	No
Mail-in applications	10%	90%	90%	10%	10%
In-person applications	90%	10%	10%	90%	90%

Source: HRDC and Canadian Passport Office

¹ A record of employment issued by the former employer supports the application.

² HRDC uses the CPP records of contributions to confirm identity.

³ HRDC uses the CPP records of contributions to confirm identity. For those who have not contributed, only one identity document is required.

⁴ One or two additional identity documents are required for in-person applications.

⁵ An eligible guarantor signs the application.

16.51 The risks associated with mailed applications remain significant, however. An HRDC investigation of SIN cards sent to mail drops in a region identified 37 suspect SIN applications. Further analysis showed that 10 of those were based on falsified documents and the individuals did not exist in a provincial vital statistics registry. In another case of fraud, an investigation revealed that a man had obtained 72 SIN cards using the identities of deceased children; those applications had been mailed directly to Bathurst.

16.52 About 20 percent of total SIN cards issued annually are to replace cards that owners have reported lost, stolen or broken. Controls on this activity need to be improved. If a certain number of replacement cards have been issued to an applicant within 12 months, a request for an additional card automatically triggers an investigation. But other warning signs, such as a number of cards mailed to the same address, are not used to monitor potential fraud.

16.53 In looking for best practices, we found that the Passport Office has a more comprehensive proof-of-identity program. It has compiled all the possible variations of birth certificates among the 12 provincial and territorial jurisdictions and makes this information available to its front-line clerks. For each application, it also requires one guarantor whose status can be checked. It maintains a list of potentially fraudulent users against which new applications are compared. It has selected a validity period of five years (compared with 10 years for similar documents in most other countries). The Passport Office also favours in-person applications over those mailed in (which represented only 10 percent of applications in 1997-98). Moreover, the Canadian passport contains several security features. However, the Passport Office shares the concerns about birth certificates and other primary documents discussed in the following paragraphs.

Relying mainly on the birth certificate as the foundation of identity has major drawbacks

16.54 One document is generally required to apply for a SIN. The document most fundamental to obtaining a SIN is the birth certificate, issued by the provinces and the territories. The birth certificate has the following limitations. It is:

- easy to obtain — television programs, various books and even Internet sites provide instructions for obtaining birth certificates to create false or multiple identities;
- relatively easy to forge or alter, especially for older certificates, given the current technology for colour duplication;
- paper-based, so it deteriorates rapidly, making information harder to verify; and
- not linked to the bearer through any special security features.

However, it is much more difficult to falsify the initial application to register a birth.

16.55 A research study prepared for the Federal/Provincial/Territorial Working Group on Common Client Identifiers and released in the spring of 1997 noted that those weaknesses are shared by a number of Canadian identity documents considered acceptable for obtaining a SIN. The noted weaknesses are most problematic in birth certificates, however, as they are often used to obtain other identification that is considered more secure because it carries a photograph (driver's licenses and health cards, for example). Widespread reliance on documents issued by various agencies creates an interdependence (A relies on B who relies on C who relies on A). This makes all parties more vulnerable. For example, with a SIN and a birth certificate, the bearer has access to a number of social programs. We noted that a birth certificate with a SIN is also acceptable for OAS applications. The HRDC Income Security Programs Branch, which is responsible for OAS, has not assessed the reliability of this document.

16.56 For the SIN, the extent to which the identity document is validated depends on the ability of HRDC clerks and agents to recognize fraudulent or falsified documents. The large number of documents accepted by the Department in support of SIN applications makes this task even more difficult. There are up to 37 types of documents that can be accepted and, moreover, among the 12 provincial and territorial jurisdictions there are several variations of birth certificates. Design changes in documents, lack of photographs, the mobility of individuals who may be carrying identification produced in many different jurisdictions, all make it increasingly difficult for program staff who review documents to identify forgeries or altered information. As well, the reliability of these documents is not given a rating and so the Department's approach is not tailored according to the quality of identity documents provided by issuing organizations.

16.57 In provincial programs, the SIN plays a key role in establishing the identity of a person applying for services, either through examination of the presented SIN card or by data matching using the number. The SIN card is accepted as original proof of identity in five of the eight provincial programs we reviewed.

16.58 The SIN card was not designed to identify the bearer. Thus, the SIN card has no security features that are unique to the bearer (photograph, description, or other characteristics such as fingerprints and retinal scan) and that could serve to prevent and deter falsification and improper use of the card (see Exhibit 16.6 for some of these security features).

Exhibit 16.6 is not available, see the Report.

16.59 Human Resources Development Canada should:

- **update the proof-of-identity program, not reviewed thoroughly since its inception in 1976, to make it more rigorous and more compatible with the other programs it supports;**
- **assess the reliability of identity documents used to support applications for a Social Insurance Number and its other programs such as Canada Pension Plan and Old Age Security, and implement corrective measures where necessary; and**
- **investigate the feasibility of either upgrading the security features on the Social Insurance card or dispelling perceptions that it is an official proof of identity.**

Human Resources Development Canada's response: Agreed. HRDC will review the process for SIN applications with a view to strengthening the proof of identity required of applicants. In addition, HRDC agrees to review proof-of-identity requirements in respect of applicants for HRDC benefit programs. HRDC emphasizes that the Social Insurance card is not and was never intended to be an identity document. However, HRDC recognizes that the card might nonetheless be used in this way and agrees to study what might be required to ensure proper usage of the card in light of government policy concerning the use of the SIN.

Investigations of Fraud and Abuse Related to the SIN

Minimal effort is dedicated to SIN investigations

16.60 The previously noted weaknesses make the SIN vulnerable to abuse. Section 141(1) of the *Employment Insurance Act* makes it an offense to:

- knowingly apply for more than one SIN;
- use someone else's number to deceive or defraud;
- loan or sell a SIN or a SIN card to deceive or defraud Employment Insurance; and
- manufacture or duplicate a SIN card.

16.61 It is worth noting that this section of the *Employment Insurance Act* goes beyond the Employment Insurance program itself and covers illegal use of the SIN to defraud other programs (such as revenue collection, social assistance, etc.), other individuals or companies. It is also an offense under section 102 of the *Canada Pension Plan Act* to knowingly furnish any false or misleading information in applying for a SIN.

16.62 Since HRDC is responsible for controlling the SIN, it is vital that it conduct proactive and effective investigations in order to prevent, detect and deter abuses that could potentially cost taxpayers many millions of dollars and cause hardship.

16.63 Identity theft — the illegal use of a person’s identity information, including the SIN — is a growing phenomenon in North America. For instance, an American government agency’s investigations of financial crimes involving identity fraud estimated that actual losses to the victimized individuals and institutions totalled US\$745 million in fiscal year 1997. Other costs of identity theft can also be very high, though not easily quantifiable. Individual victims can suffer injury to their reputation and must undergo the process of clearing their credit rating. In the interim, these individuals may be unable to keep or find a job, obtain a home mortgage or secure a loan.

16.64 The Investigation and Control Directorate of the Employment Insurance Program is responsible for investigating suspected attempts to defraud the Program. Abuse of the SIN is only one of the forms of fraud this Directorate investigates. In 1996-97, it conducted 958,000 investigations that resulted in total savings of \$564 million. However, the savings from investigations that HRDC specifically attributed to the abuse of the SIN represent only a minute fraction of that amount. SIN-related savings for programs other than Employment Insurance are not included and SIN investigations are not always classified as SIN-related. Moreover, the already small number of investigations continues to decline. As shown in Exhibit 16.7, there were 2,730 investigations of SIN abuse in 1997-98, a decline of 52 percent from 1993-94.

Exhibit 16.7 is not available, see the Report.

16.65 The Income Security Programs Branch conducted even fewer SIN-related investigations than the Employment Insurance investigators. Given the generally recognized higher risk of fraud represented by mail-in applications (explained in paragraph 16.50), certain income security programs may be very vulnerable to fraud. Indeed, a pilot project jointly conducted by the Investigation and Control Directorate and the Income Security Programs Branch shows that there is considerable room for a more proactive approach to detecting these frauds.

SIN investigations could provide substantial results

16.66 There are many types of SIN abuses that lead to investigations. SIN abuses are reported by Revenue Canada, Employment Insurance, Canada Pension Plan, Old Age Security and by provinces. Others are reported by financial institutions (banks, credit bureaus), major retail stores and public utilities. In one province, we noted a higher proportion of cases connected to abuse of provincial social services. Many abuses involve someone using a legitimate SIN of another individual to work or to pay less income tax. The legitimate taxpayer may subsequently be reassessed and asked to pay the taxes on this impostor’s undeclared income. In such cases, the legitimate taxpayer is advised to contact HRDC and request an investigation. We estimate that income-tax-related investigations represent 17 percent of the SIN investigation workload. As a result of those investigations, in the last five years Revenue Canada has made 1,132 corrections to tax records that represent income totalling \$36 million.

16.67 Some investigations have produced impressive results that demonstrate the significance and potentially high materiality of SIN-related fraud. Such investigations often involve a large number of stolen, invalid or fraudulently obtained SINs and frequently represent large sums of money for the government and individuals. Exhibit 16.8 summarizes some of these investigations, reported to us by departments. It includes investigations conducted by Revenue Canada that also illustrate the potential for recovering funds through investigation of SIN frauds.

Exhibit 16.8

Examples of Fraud Investigation Cases Related to the Social Insurance Number

Human Resources Development Canada (HRDC)

- Three individuals who had applied and received 20 false SINs went to a local dealership to lease 18 luxury vehicles purportedly for the new business they were starting. Once they had taken possession of the vehicles they transported them to another city where they were loaded into containers on a freighter going overseas. By the time the police caught up with them, 15 vehicles had been unloaded in another country and only three were seized. The three main suspects had fled to another country. The total value of the

fraud perpetrated was \$1.1 million.

- An individual currently under investigation by HRDC succeeded in obtaining 30 false SINs, which he used to file 25 Employment Insurance applications. The potential loss to the Department could be in the neighbourhood of \$450,000.
- A placement agency provided work to welfare recipients. The agency also provided invalid SINs to those individuals so that they could work while collecting social assistance benefits. This involved 1,295 invalid SINs over a period of seven years, resulting in estimated annual losses of up to \$10 million dollars to the social assistance department in the province.

Revenue Canada

- An individual entered a major retail food company's warehouse and obtained a number of SINs from employees' time cards. These SINs were used to register 27 fictitious companies, which filed Goods and Services Tax (GST) net tax refund returns totalling approximately \$254,000.
- An individual used the SINs of six persons to register 22 fictitious companies and filed 133 GST returns declaring fictitious purchases in the amount of \$680 million. He attempted to obtain GST refunds for an aggregate amount of \$12,440,918.
- An individual used phony help-wanted ads to obtain personal information about people, including SIN numbers, and then used this information to generate fictitious income tax returns for which Revenue Canada issued tax refunds. Using the SINs of 86 persons, the individual managed to fraudulently obtain \$239,000.

Source: HRDC and Revenue Canada

16.68 Our field visits to some provincial departments demonstrated that abuse and fraud using multiple identities is also present and can be detected. Some of these organizations have special investigation activities to address issues of abuse and fraud. Results clearly demonstrate that theft of identity occurs.

The quality of SIN investigations needs to be improved

16.69 Our review of investigation files revealed several weaknesses in the quality of the investigations conducted. For instance, we estimate that fewer than one percent of investigations ultimately generate a strong enough case to lay charges. In one region, investigators were instructed to stop SIN investigations related to income tax at the point where the hardships caused to the legitimate taxpayers had been contained, and to make only limited efforts to identify the perpetrators. We also noted little effort to identify root causes in investigation reports. Only five percent of the investigation files we reviewed contained references to lessons learned and possible corrective action to prevent a recurrence of the activities.

Existing performance indicators discourage SIN investigations

16.70 Since 1992, HRDC has implemented a results-based approach to its investigations. They are now assessed using a performance indicator that focusses on total savings generated by investigations. It is based on the dollar value of overpayments, penalties and prosecutions and the value of prevented mispayments. The Treasury Board Secretariat has accepted the indicator as a reasonable and realistic measure of investigative performance and it is now used to determine resource allocations.

16.71 However, because of the pervasive use of the SIN, this type of fraud also affects other federal departments, provincial, territorial and municipal social services and the private sector. As shown in Exhibit 16.2, Employment Insurance frauds represent only one of many ways the SIN can be used to commit frauds of various kinds. The savings to other programs that are generated through SIN investigations are not attributed by HRDC to Employment Insurance investigators. The Department told us that it had not yet put forward a business case to the Treasury Board for changing the indicators to reflect savings to other programs. Furthermore, when a SIN investigation has a high dollar value or involves a complex scam, the Department often codes it as major fraud or a "third-party denunciation" and the savings generated are not credited to SIN investigations. The end result of the performance

measurement model currently used by the Department is that Employment Insurance investigators give SIN investigations very low priority. This, more than anything else, explains the steady decline in the number of SIN investigations and the unsatisfactory quality of those that are conducted.

16.72 The decline in the number and quality of SIN investigations can also affect the integrity of the SIN data base. A proactive and effective investigation function is necessary to minimize fraudulent activities. Major weaknesses in the system that come to light through investigations need to be recognized and corrected to prevent their recurrence.

16.73 Human Resources Development Canada should redesign its performance indicators for investigations of abuse of the Social Insurance Number to recognize their importance to not only the Employment Insurance program but also other federal, provincial, territorial and municipal programs.

Human Resources Development Canada's response: Agreed. HRDC recognizes the importance of detecting and preventing fraudulent use of the SIN. The value of SIN investigations needs to be defined, particularly in relation to the additional resources required to devote to this increased activity. HRDC will review its performance indicators accordingly.

Penalties resulting from successful SIN investigations are minimal

16.74 The *Employment Insurance Act* states that the penalty for committing any offenses related to the SIN is a fine of up to \$1,000 and/or imprisonment for up to one year. Charges under the Criminal Code can also be pressed. As we have noted, however, very few perpetrators are caught, and even then the Department rarely brings criminal charges. In the files we reviewed, the only case in which charges were laid ended in a fine of \$200.

16.75 Such low fines do not appear to warrant the considerable time and effort that prosecution entails, and their deterrent effect is doubtful. Thus, there is effectively no penalty for activities that could cause considerable damage to social programs, tax collection, commercial activities and the privacy and security of individual Canadians. Administrative penalties such as those applied in cases of Employment Insurance abuse would provide more flexibility, be less costly to administer, deter potential abusers and better protect Canadians from illegal use of the SIN.

16.76 Human Resources Development Canada should explore the possibility of applying administrative penalties for offences related to the use of Social Insurance Numbers.

Human Resources Development Canada's response: HRDC agrees to explore the application of administrative penalties in cases involving fraudulent use of the SIN. This will take into account the requirements for change in the Employment Insurance legislation and the legal and administrative issues associated with implementing and enforcing the legislation, including recovery mechanisms.

Impacts on Other Users

Use of SIN as a de facto national identifier has caused numerous problems for other users

16.77 Finding misuse and abuse in any system can be compared to “looking for a needle in a haystack”. The way the SIN is managed or not managed has repercussions throughout the income security and revenue collection systems. While the visible impact on any one program may be minimal, the collective impact can be significant. Examples we encountered during our work illustrate this.

16.78 Revenue Canada relies on the master file provided by SIR to validate the identity of new tax filers. In the event that identity cannot be validated by SIR, Revenue Canada told us it requests identification documentation from the individual. Revenue Canada also has internal controls that can compensate for errors and catch them after the fact. However, they still leave Revenue Canada vulnerable to inaccurate information found on the SIR data bases due to, among other things, SIN applications that are fraudulent from the outset.

16.79 In the last few years, a range of cases detected by Revenue Canada investigations revealed a variety of SIN frauds that involved benefit programs of several other departments, both provincial and federal. These fraud cases allowed the perpetrators to fraudulently gain millions of dollars in benefits. Among the many factors that made these frauds possible was the inability to readily verify birth and death data. In some cases, SIN numbers had been stolen from company files.

16.80 As discussed in paragraphs 16.44 and 16.45, the lack of an expiry date on temporary SINs causes problems for Citizenship and Immigration Canada and Revenue Canada and allows abuse and misuse.

16.81 In the tax year 1993, Revenue Canada received 73,000 tax returns on which the SINs could not be linked to identified taxpayers. It has managed to reduce this number substantially. However, in 1994 (the last year for which Revenue Canada could readily provide up-to-date information on this matter) it still had about 47,000 taxpayers on its books who did not match with the SIR and who represented more than \$72 million in income.

16.82 The provinces do ask that applicants for benefits provide a SIN. However, an applicant can refuse to do so and still receive benefits. The *Income Tax Act* and Regulations require that every province that pays social assistance and workers' compensation to an individual obtain that individual's SIN for use on the T5007 slip, which reports these payments. Although the rate of provincial compliance with that requirement is relatively high, according to Revenue Canada (96 percent of applicants provide SINs), the 110,000 SINs representing the remaining 4 percent translate into \$500 million in social assistance and workers' compensation payments for tax year 1996. The slips without a SIN have only a name and an address. There is no birth date, so matching is very difficult.

16.83 Provinces, who are among the main users, do not yet have official access to the SIR although HRDC states, based on advice from the Department of Justice, that it is now possible. They do not receive information on the five million SIN flags in the system (deceased, fraudulent, cancelled, etc.); this causes problems for the integrity of their data bases. A test by HRDC comparing data in the SIR with provincial data for two medium-sized cities and one province showed inaccuracies in both the SIR and the related data for up to 10 percent of the social assistance population. We noted that where the agency using the SIN has no way of verifying its legitimacy, a knowledgeable applicant can create a number that will work in the system. The financial institutions — who are required by law to collect the SIN for income-related transactions — are likely to face the same problems.

16.84 HRDC has been working within the existing legal framework of the *Employment Insurance Act* to try to provide access to the SIR for users other than those officially authorized, especially the provinces (see paragraph 16.103 for further explanation). We noted that the provinces have their own privacy legislation that regulates their governments' use of personal information.

Legal and Policy Framework for Managing the SIN

Privacy of information is a key dimension of managing the SIN

16.85 Privacy issues revolve around the rights of individuals to exercise control over their personal information. We have thus far dealt with issues related more to the reliability and integrity of the SIN. It is important to make a distinction between security and privacy; a perfectly secure and fraud-proof system could nonetheless be highly intrusive.

16.86 The right to information privacy can be defined as the right of individuals to determine when, how and to what extent they will share personal information about themselves with others. This generally implies that personal information will be used only for the primary purpose intended and with the consent of the individual where not provided for by law. The individual has the right to review the information for accuracy.

16.87 The goals of administrative efficiency and service delivery must be balanced against the often competing objective of maintaining individual privacy. The history of the SIN has reflected this tension.

16.88 The use or abuse of the SIN in violation of privacy has been a concern among Canadians, in particular the fear that it will be used as a universal identifier to create a national data base. Over the years, several hundred inquiries and complaints received by the Office of the Privacy Commissioner have been related to the inappropriate use or disclosure of SIN-related information.

Extensive use of personal information by HRDC attracts attention of privacy advocates and the Privacy Commissioner

16.89 Apart from being the custodian of the SIR, HRDC is one of the most important federal departments involved in the collection and use of personal information. It also has large internal data banks on nearly all Canadians that link personal information and are used for management of programs, evaluation and research.

16.90 HRDC has over 250 agreements with many partners that deal with the receipt or exchange of personal information. These agreements are reached pursuant to a specific provision in HRDC's or the other partners' legislation that authorizes such exchanges of information. At the end of 1997, HRDC classified 20 such exchanges as data matches, 13 of which were with Revenue Canada.

16.91 HRDC has a structure in place for administering the *Privacy Act* and the Treasury Board policy on data matching and control of the SIN. There are privacy co-ordinators in each regional office. HRDC officials informed us that all their data-sharing agreements are reviewed by their in-house legal counsel to ensure compliance with the *Privacy Act*. Our review of information obtained from the Privacy Commissioner revealed that of the 36 notifications of proposed new data matches received since 1989, 50 percent came from HRDC. We noted that there is ongoing dialogue between HRDC and the Privacy Commissioner on privacy issues.

16.92 The Office of the Privacy Commissioner, an independent oversight agency reporting directly to Parliament, recently completed a study for the purpose of examining HRDC's formal strategies for the collection, retention, use and disclosure of personal information. The study was not a compliance review under section 37 of the *Privacy Act*; although it did contain recommendations, it did not specifically look for unreported data-matching activities.

16.93 The Privacy Commissioner's study concluded that, overall, HRDC employees demonstrated a good level of privacy awareness. It highlighted areas where the Department was doing well and identified privacy issues to pursue. In particular, the study noted that the Commissioner's Office will be working on a consultative and ongoing basis with HRDC's officials to provide input on such privacy issues as the Common Client Identifier project and access to the Social Insurance Register information. Any issues that the Privacy Commissioner considers significant will be dealt with directly by his Office. We did not seek to duplicate his work.

16.94 We found that assessing compliance with data-matching policy and guidelines is a contentious area, given the various forms of data matching possible. Current responsibilities and controls over data matching need to be revisited with a view to ensuring adequate protection of personal information (see Exhibit 16.9 for further explanation).

Exhibit 16.9

Legislative and Policy Framework Governing Data Matching

A Parliamentary Committee Report Calls for Improvements in the Canadian Privacy Framework

A recent parliamentary committee report (April 1997) entitled “Privacy: Where do we draw the line?” outlined a number of areas needing improvement in the Canadian privacy framework and made several recommendations. This report was produced by the House of Commons Standing Committee on Human Rights and the Status of Persons with Disabilities.

The report stated that there is no comprehensive national system of data protection in Canada. It called for comprehensive data protection legislation that would include, among other things, strict protections against unnecessary data matching and standards for acceptable data-matching practices. In particular, the committee’s report stated that the current *Privacy Act* provides for little specific control of data matching.

The Data Matching Policy Is Issued by Treasury Board

Data matching is the comparing or linking of personal information obtained from different sources for the purpose of making decisions that could affect the individuals to whom the information pertains. It usually involves the exchange of personal information between government institutions or programs, and this exchange must be in accordance with the use and disclosure provisions as well as the other relevant sections of the *Privacy Act*.

As currently defined, an exchange of information is not necessarily a data match if the purpose is not to make decisions affecting individuals. For example, an exchange of information for research purposes is not considered a data match, as no decisions are made about individuals. The concept of data matching and the related role of the Privacy Commissioner are not specifically defined in the *Privacy Act*. However, there is a data matching policy issued pursuant to the authority of the President of the Treasury Board as the “designated Minister” under section 71 of the *Privacy Act*. The “head” of a government institution is responsible for ensuring that the institution complies with the legislation and associated policy and, ultimately, for rendering decisions related to matching activities.

The policy on data matching requires federal agencies to submit proposals for matching to the Privacy Commissioner 60 days in advance. He then reviews or assesses the match against a set of criteria (including compliance with relevant sections of the *Privacy Act*) and acts as an advocate for the subjects of the files. He does not have the power to halt any data-matching proposal. However, he can make recommendations to a department or report to Parliament if he believes that the proposal violates the guideline or the principles of the Act.

Responsibilities and Controls Over Data Matching Need to Be Reviewed

Since the introduction of the Treasury Board policy on data matching in 1989, the Privacy Commissioner has received for review 36 notifications of proposed new data matches for about 150 government institutions. In the past, the Privacy Commissioner has raised concerns about whether all data-matching activities of federal government institutions (as well as the related “consistent uses” of personal information) were reported to his Office for review. Our interviews with staff of the Privacy Commissioner and our review of their surveys revealed that concerns still exist.

We noted that the policy does not precisely indicate if the Privacy Commissioner should investigate any unreported data matching by government institutions. The Privacy Commissioner informed us that his Office has not carried out any specific audit of data matching in the past. However, any data-matching activities that had not been reported by government institutions to his Office for review but that came to the staff’s attention in the course of their compliance review would be addressed accordingly. There could be a significant gap in the oversight of data matching.

We noted in the policy that the same rules apply equally to all forms of data matching, such as matching on a personal or aggregate level, internal or external matching, up-front or ex post facto matching, etc. The cost/benefit and reporting requirements of the policy are the same regardless of the privacy risks (the potential negative consequences for the individual) inherent in each form of data matching. It is unclear how the data-matching policy applies to federal/provincial/territorial government data matching. Finally, as noted above by the Committee, there are no standards or criteria for acceptable data-matching activities. The 1989 policy does not reflect continuing changes in the technological environment.

A related issue is how the principle of consistent use, enshrined in the *Privacy Act*, is put into practice. The *Privacy Act* permits the disclosure of personal information “for the purpose for which the information was obtained or compiled by the institution or for a use consistent with that purpose.” The Act does not define the concept of “consistent use”, and related guidance provided by the Treasury Board is limited. The purposes for which personal information is obtained are generally defined in broad terms. As a result, a significant amount of sharing of personal information could be justified as consistent. About 1,300 consistent uses are reported in InfoSource, a

central index of personal information held by government institutions. The Treasury Board has not defined any standards or criteria for acceptable “consistent use”.

Responsibility for developing and reviewing the policy on data matching rests with the Treasury Board, not with the Privacy Commissioner. Treasury Board mainly relies on departments to comply. Overall, there is limited monitoring of the nature and extent of data-matching activities in each federal government institution or whether the SIN is used only by authorized users. The Treasury Board does not monitor whether government institutions have reported all their proposed data matches to the Privacy Commissioner for review. Further, it does not gather comprehensive information about data matching in the federal government with a view to identifying best data-matching practices and lessons learned for sharing with other government institutions.

Unregulated use of SIN in the private sector is a key vulnerability

16.95 The use of the SIN is not regulated in the private sector except in Quebec, where private sector use of personal information is regulated by legislation. Unregulated and pervasive use of the SIN in the private sector is seen as a key flaw by privacy advocates because the SIN can be used to violate privacy and to steal identity.

16.96 Industry Canada and the Department of Justice have started to address the issue of regulating privacy in the federally regulated areas of the private sector. Legislation is expected this fall. However, even if the proposed legislation did address misuse or abuse of the SIN, it would not address the provincially regulated areas of the private sector.

16.97 Certain areas of the private sector have begun to adopt voluntary privacy codes, generally based on the Canadian Standards Association Model Code for the Protection of Personal Information. In a report released in January 1998, Industry Canada and the Department of Justice said that the current “patchwork” of laws, regulations and privacy codes was not adequate given, among other things, the federal government’s increasing exchange of personal information with the private sector. Private businesses are more and more involved in the delivery of government services through the contracting out or privatization of some government functions.

16.98 During our audit we asked various government stakeholders, including the Department of Justice and Industry Canada, to provide us with any studies they had done in the past 15 years on the impact and extent of the use of the SIN in the private sector. No such studies were available. Access to this kind of assessment would be invaluable in determining the potential restrictions of the SIN in the federally regulated private sector, which could then be considered in the upcoming federal privacy legislation.

16.99 **The government should seriously consider conducting an assessment of the impact and extent of private sector use of the Social Insurance Number, and use the upcoming privacy legislation as an opportunity to address long-standing concerns about related privacy issues.**

Industry Canada’s response: Industry Canada has consulted with the Department of Justice in the preparation of this response to the recommendation regarding the use of the SIN by the private sector. We have noted the Auditor General’s interest in the use of the SIN by the business community, and share his views that further study of the extent of that use would be valuable. We will be examining ways to obtain more accurate information in this regard, in concert with other interested government departments. We also note the reference to the legislation that Industry Canada and the Department of Justice will be introducing shortly to protect personal information in the private sector. We believe that this legislation will address the issue of unnecessary collection and misuse of personal information, including the SIN, and we will study the recommendation for further specific protection of the SIN in the context of our ongoing work on this legislation.

Progress in clarifying the role and improving the management of the SIN is slow

16.100 HRDC and other players have made several attempts to improve the management of the SIN. In 1990, the Evaluation section of HRDC issued a report and made a number of recommendations aimed at improving the

application process and the reliability of the data base. An Interdepartmental Task Force on the Integrity of the Social Insurance Register was formed in 1994. Its initial mandate was to deal with residency issues related to Goods and Services Tax Credit and Child Tax Benefit payments, the transfer of Revenue Canada's death data to the SIR and the exchange of information on SINs found to have been used for fraudulent purposes. In 1994, staff responsible for the SIR issued a report entitled "Modernization of the SIN: The Key to Social Security Reform".

16.101 The response to these events, although difficult to attribute to any one of them specifically, was a number of system improvements and new data-sharing activities. They also led to better co-ordination and the use of common guidelines between Revenue Canada and HRDC on handling victims of identity theft and communicating information on false or problem SINs in the system.

16.102 Phase II of the Interdepartmental Task Force to address more fundamental issues was never undertaken and its activities were suspended sometime in 1995. The reasons for not proceeding further with this specific initiative were never stated officially.

16.103 As discussed in paragraphs 16.83 and 16.84, HRDC has been working within the existing legal framework of the *Employment Insurance Act* to try to provide access to the SIR for users other than those officially authorized, especially the provinces. A revised policy on the new uses of the SIR arising from advice given by the Department of Justice was recently approved by the Employment Insurance Commission. This policy states that SIR information can be shared with federal, provincial, territorial and municipal government agencies involved in providing financial assistance, whether in the form of welfare assistance, training benefits or grants or workers' compensation payments. HRDC told us it plans to facilitate access through written agreements with the provinces, similar to the labour market agreement process.

16.104 We note that the revised policy approved by the Commission, which grants greater access to the SIR, supports its continued use by other jurisdictions. This seems to be inconsistent with the Treasury Board policy aimed at preventing expanded use of the SIN. The Office of the Privacy Commissioner states that it is working closely with HRDC officials to provide input on the privacy issues related to expanded access to the SIR.

16.105 In 1996, HRDC and provincial and territorial social service departments began an initiative aimed at delivering social services more efficiently and effectively through the use of a common client identifier (CCI). The core options considered, apart from the status quo, for use as a CCI by the Federal/Provincial/Territorial Working Group were the following:

- use of the current SIN for all federal/provincial/territorial income security clients, with the current configuration and administration of the SIN;
- modernization of the SIN with digitized personal and security information, linking the card to the holder; and
- establishment of a new client identifier to replace the SIN.

While the research raised a number of key issues associated with each, it appeared to favour using the SIN, even with its apparent weaknesses.

16.106 It quickly became evident that this initiative would need considerable support to overcome the political sensitivities associated with privacy issues. In July 1997, HRDC wrote officially to the Treasury Board stressing the need for a government-wide privacy framework, particularly given the growing momentum toward use of a common client identifier.

16.107 At the time of our audit, HRDC had not completed the subsequent business case for the Common Client Identifier project, so we are not able to comment on its conclusions.

16.108 A recent research study (January 1998) done on behalf of HRDC and the Federal/Provincial/Territorial Working Group on Common Client Identifiers examined the experiences and lessons learned in the introduction and use of a CCI in seven other jurisdictions. All of the jurisdictions studied have considered or are now implementing a CCI. In a few of these countries, identification numbers have proliferated in much the same way as in Canada. Exhibit 16.10 highlights some of the experiences and lessons learned. The study concluded that using an existing number with which the public is comfortable has found better acceptance; successful experiences with a CCI have used an existing number rather than introducing a new identifier. Smaller-scale application of a CCI, aimed at specific clusters of programs such as income security programs and using an existing identification number, was one approach used by other jurisdictions.

Exhibit 16.10

Some International Experiences and Lessons Learned from the Introduction and Use of a Common Client Identifier in 7 International Jurisdictions

<p>International jurisdictions</p> <ul style="list-style-type: none"> • Australia, Belgium, France, Ireland, United Kingdom, United States and California <p>Balancing competing objectives</p> <ul style="list-style-type: none"> • All of the jurisdictions examined had to deal with balancing the often competing objectives of maintaining individual privacy and confidentiality and improving administrative efficiency and effectiveness. <p>Data matching</p> <ul style="list-style-type: none"> • The main impetus for using a Common Client Identifier (CCI) was the need to facilitate accurate and timely data matching. The CCI is the key to accurate data matching and better verification of identity. • In general, jurisdictions stated that accurate data matching led to improved service delivery and administrative efficiencies, and reduced levels of fraud and abuse. One jurisdiction’s additional reasons for using a CCI were better integration of social services and simplification of systems and procedures. <p>Data protection</p> <ul style="list-style-type: none"> • The introduction of a CCI sparked a debate about data protection in the jurisdictions. In some jurisdictions, the debate culminated in the adoption of new data protection legislation. In others, the debate led to a decision not to use a national identifier. <p>Legislative framework</p> <ul style="list-style-type: none"> • Legislation required significant revisions to provide a workable framework for data matching. Countries had to deal with the following issues when revising or developing legislation: the circumstances under which data matching would be considered lawful; protocols to curtail and control inappropriate matching; how information would be obtained fairly; parameters for use and disclosure of information; and effective security measures to safeguard personal information. • In certain jurisdictions, the introduction of a wide-scale national CCI was abandoned because the public was not confident that the government’s legislation would protect the citizenry from an encroachment on personal privacy.
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Source: Internal Study done on behalf of HRDC and the Federal/Provincial/Territorial Working Group; January 1998 (not audited).

16.109 The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

16.110 There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized.

Conclusion

16.111 Our audit objective was to determine whether the management and control of the SIN is efficient and effective and has an appropriate basis in the legislation. Our audit findings highlighted the numerous problems associated with the use of the SIN as well as its inherent unreliability. There is a critical gap between the framework for the SIN and the role it now plays in Canadian society. The SIN was originally conceived as a file numbering system to identify individuals collecting Unemployment Insurance and CPP benefits, not as a means to accurately identify individuals across the national income security and tax collection systems. Given the pervasiveness of the SIN, the proof-of-identity procedures are flawed, the information in the SIN data base is not always complete and accurate, there is minimal protection for individuals whose numbers are misused, and the penalties for misuse are weak and difficult to apply. As well, there is little privacy protection for owners of a SIN, particularly in the private sector. These fundamental issues remain unresolved.

16.112 We have determined that major improvements are possible and need to be made. We noted that initiatives to achieve such improvements have been hampered by perceived political sensitivities over impacts on privacy and by a lack of leadership.

16.113 The implications of legitimizing the use of the SIN as a common client identifier for income security and revenue collection programs in Canada need to be fully debated and compared with alternatives.

16.114 In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness and finding a satisfactory solution.

Joint comments of Human Resources Development Canada, Department of Justice and Treasury Board

Secretariat: *The federal government remains strongly committed to the principles governing the protection of privacy. The Treasury Board Secretariat, Department of Justice and Human Resources Development Canada work together in their respective roles and responsibilities regarding the SIN. HRDC is dedicated to diligent stewardship of the SIN and is in general agreement with the observations and findings arising out of the audit concerning its responsibilities related to the issuance of social insurance numbers, maintenance of the Social Insurance Register, and investigation of suspected abuse. The recommendations will provide additional support to work already under way in many of these areas with other federal government departments and provincial and territorial partners.*

In this chapter, the Auditor General has noted the expanded use of the SIN and access to the SIR by governments for operational effectiveness and efficiency purposes. The use of the SIN within the federal domain is regulated by specific legislation. As the chapter indicates, HRDC's administration of the SIN is in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs.

As the chapter also notes, the provinces have their own privacy legislation that regulates their governments' use of personal information.

The Auditor General is concerned with private sector use of the SIN and the perception this may create that the SIN is becoming a national identity number. The chapter also refers to the fact that the government will be introducing legislation in the near future to protect personal information in the private sector. We believe that this legislation will address the issue of unnecessary collection and misuse of personal information, including the SIN.

Should there be any future changes to the legislative framework authorizing new or different uses of the SIN, Treasury Board Secretariat, Department of Justice and HRDC will work with interested stakeholders to ensure that associated policies are revised and that they meet operational requirements.

About the Audit

Objectives

The objective of our audit was to assess the management and control of the SIN to determine if it is efficient and effective and has an appropriate basis in legislation. More specifically, we sought to:

- examine the role and uses of the SIN;
- examine and assess the SIN application process and the management of the Social Insurance Register;
- assess the investigations of fraud and abuse related to the SIN; and
- assess its basis in legislation.

Scope

Our audit covered:

- the role and use of the SIN in the management of various Canadian social programs;
- the application process and management of the Social Insurance Register;
- the proof-of-identity program for the SIN;
- the investigations of fraud and abuse related to the SIN;
- the efforts made to improve the SIN; and
- the legislation, policies and guidelines related to the SIN.

We interviewed officials and reviewed documentation at HRDC headquarters and in other federal departments and agencies who are users of the SIN (Revenue Canada and Citizenship and Immigration Canada), those who have responsibilities with respect to the SIN (Treasury Board Secretariat, Department of Justice and Office of the Privacy Commissioner) and those who have relevant experience (Royal Canadian Mounted Police, Industry Canada, Passport Office and Elections Canada). We also interviewed officials in three provinces whose departments and agencies are users or stakeholders of the SIN (such as social services, workers' compensation boards, health services, motor vehicle bureaus, etc.). We visited nine Human Resource Centres of Canada in Ontario, Quebec, Alberta and British Columbia and the Social Insurance Register in Bathurst, New Brunswick. We analyzed planning documents, minutes of meetings, internal studies, performance reports and other related documents.

Criteria

- The SIN application process should be controlled in order to prevent, at a reasonable cost, the issuance of SINs to individuals who are making fraudulent applications.
- The SIN central register should be managed in a way that ensures the reliability, integrity and confidentiality of personal data; its operations should be managed in an efficient and effective manner.
- The use of the SIN and the SIN card in government programs should be well controlled to reduce abuse, fraud and inappropriate access to the personal data.
- Investigations should detect and prosecute instances of fraud and abuse in a timely, cost-effective manner. The sanctions imposed should have a deterrent effect.
- The SIN should be a reliable tool to control social programs.

Quantitative Information

The quantitative information in this chapter has been drawn from various sources indicated in the text. Unless otherwise indicated, the information has been examined for reasonableness but not audited.

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Chapter 17

Patented Medicine Prices Review Board

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Patented Medicine Prices Review Board

Main Points

17.1 The Patented Medicine Prices Review Board (PMPRB) is a small quasi-judicial board with an annual budget of approximately \$3 million and 35 full-time-equivalent employees. Created in 1987, it has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive. However, the scope of its jurisdiction and the limitations of its consumer protection role are not widely understood.

17.2 Since 1988, average annual increases in prices of patented medicines have moderated. The Board has contributed to the containment of patented drug prices, and has taken steps to assess the impact of federal price regulation. However, other factors also have contributed and we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated. In reporting its results to Parliament, the Board did not clearly identify the limitations of the estimates of its own impact.

17.3 The audit identified issues pertaining to the legislative framework that need to be reviewed. The legislation is silent or unclear on certain areas. In addition, some requirements under the legislation are difficult to apply in practice, and consideration needs to be given to reviewing their continued relevance.

17.4 The majority of patented drugs sold in Canada are priced within the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Improvements are also required in the reporting of drug price trends and pharmaceutical research and development expenditures.

Introduction

17.5 The Patented Medicine Prices Review Board (PMPRB) was created by Parliament in December 1987 under the *Patent Act*. It has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive.

17.6 The PMPRB is a quasi-judicial body whose main activity is regulating the maximum prices charged by manufacturers of patented drugs sold in Canada. The Board also reports to Parliament through the Minister of Health on its activities, on trends in all drug prices, and on research and development spending by pharmaceutical patentees.

17.7 The Board is located in Ottawa and comprises up to five members, including a Chair and a Vice-Chair, appointed by the Governor in Council to serve on a part-time basis. The Chair is designated the Chief Executive Officer, with authority and responsibility to supervise and direct the work of the Board, including the duties of its staff. Reporting to the Chair is the Executive Director, who manages the work of Board staff. In 1997-98, the Board had 35 full-time-equivalent employees, with a budget of approximately \$3.1 million.

Historical context for federal regulation of patented medicines

17.8 Since 1923, the *Patent Act* has had special provisions relating to patented medicines. The federal government has attempted to balance its desire to achieve lower prices for medicines against the need for a patent system that encourages development of new medicines through providing exclusive rights to manufacture patented drugs.

17.9 From 1923 to 1969, the Act allowed the Commissioner of Patents to grant a compulsory licence to any manufacturer for the purposes of preparing and selling a medicine in Canada by paying to the patent owner a royalty fee prescribed by legislation. Under this scheme, patent owners did not have exclusive rights to their patented inventions.

17.10 In 1969, the government introduced changes to increase the use of compulsory licensing whereby manufacturers could also import a patented invention to produce and sell copies of patented medicines, usually in the form of lower-priced generic drugs.

17.11 In 1987, however, the government brought forward changes to limit the use of compulsory licensing of patented medicines. In return for more patent protection, the brand name pharmaceutical industry made a public commitment to increase its annual research and development spending to 10 percent of sales by the end of 1996. To ensure that pharmaceutical patentees would not charge excessive prices, the government established the PMPRB.

17.12 In 1993, the legislation was further amended to abolish compulsory licensing of patented medicines altogether and to strengthen the remedial powers of the Board.

The federal price regulation framework for patented medicines

17.13 The various amendments to the *Patent Act* and the associated regulations provide a framework for the federal regulation of patented medicine prices. The *Patent Act* falls under the jurisdiction of the Minister of Industry, but sections pertaining to the work of the Board are under the jurisdiction of the Minister of Health.

17.14 The legislation requires the Board to consider various factors in determining whether a patented medicine is being sold or has been sold in Canada at an excessive price. These factors are described in Exhibit 17.1.

Exhibit 17.1

Price Comparison Factors

Section 85 of the *Patent Act* specifies the following factors to consider in determining whether prices of patented medicines are excessive:

- the prices at which the medicine has been sold in Canada
- the prices of other medicines in the same therapeutic class sold in Canada;
- the prices of the medicine and other medicines in the same therapeutic class sold in countries other than Canada (as specified in the Patented Medicines Regulations, they are France, Germany, Italy, Sweden, Switzerland, United Kingdom and the United States);
- changes in the Consumer Price Index; and
- other factors as specified in the regulations.

17.15 The Act empowers the Board to take remedial action when, following a public hearing, it finds that a manufacturer of a patented medicine is charging an excessive price. The legislation also empowers the Board to issue guidelines on matters within its jurisdiction. Further, the legislation requires pharmaceutical patentees to provide information to the Board on the prices of patented medicines they sell in Canada and elsewhere. There are penalty provisions for non-compliance with the requirement.

17.16 Regulations specify the information and documents that must be provided. They include requirements relating to the prices of each patented medicine sold in Canada and its prices in foreign countries where it is sold.

17.17 In consultation with stakeholders, including the pharmaceutical industry, consumer groups and ministers of health, the Board has established a compliance and enforcement policy and published guidelines using the factors outlined in the legislation and regulations. These guidelines, which are not binding on the Board or on any patentee, are intended to limit the introductory prices of new patented medicines and the annual price increases of patented drugs already on the market (Exhibit 17.2).

Exhibit 17.2

Guidelines on Excessive Price of Patented Medicines

Existing medicines. Price increases are limited to changes in the Consumer Price Index (CPI). The excessive price test is based on a three-year cumulative change in the CPI. In addition, single-year increases are limited to 1.5 times the forecast change in the annual index. In periods of high inflation (over 10%), the limit will be five percentage points more than the forecast change in the annual index.

New medicines. The guidelines establish three categories for purposes of limiting the introductory prices of new medicines.

- Category 1 – Drugs that represent a new product of an existing or comparable dosage form of an existing medicine: The price will be presumed to be excessive if it does not bear a reasonable relationship to the average price of the same medicine in the same or comparable dosage forms.
- Category 2 – Breakthrough drugs or products that provide substantial improvement over comparable existing products: The price will be presumed to be excessive if it exceeds the higher of the cost of therapy with medicines in the same therapeutic class or the median of prices of the same drug in the seven foreign countries listed in the Patented Medicines Regulations.
- Category 3 – Drugs that provide moderate, little or no improvement over existing drugs: The price will be presumed to be excessive if the cost of therapy with the new drug is higher than the cost of therapy with existing comparable drug products in the same

therapeutic class.

In addition, the price of a patented drug cannot exceed the highest price of the same medicine sold in the seven countries listed in the regulations.

Source: Patented Medicine Prices Review Board

Current environment for regulation and control of drug prices and costs

17.18 Globally, the pharmaceutical industry is dominated by large multinational companies. In 1997, worldwide sales of drugs by manufacturers increased by about 8.6 percent over the previous year to more than \$400 billion. In the same period, Canadian sales of patented and non-patented drugs by manufacturers increased by approximately 6.0 percent to about \$7.0 billion; patented drugs accounted for \$3.7 billion of that amount, an increase of some 22.6 percent.

17.19 In Canada, spending on pharmaceutical drugs has increased faster than on other key elements of health care such as hospitals and physicians. The growing expenditures on drugs have been a concern in Canada and in other countries as well.

17.20 Increasingly, provincial governments, hospitals and other public and private operators of drug plans in Canada have adopted a variety of measures in an attempt to control their drug costs. For example, provinces have used formularies to limit the drugs eligible for reimbursement and have established ceilings for reimbursement. In 1994, Ontario also implemented a price freeze policy on all drugs listed on its formulary. Hospitals have focussed on improving their practices for dispensing and purchasing drugs.

17.21 Many industrialized countries, including Canada, have national systems that regulate drug prices or the profits of drug manufacturers in various ways.

Focus of the audit

17.22 In its April 1997 report, the Standing Committee on Industry recommended that the Office of the Auditor General audit the PMPRB to provide Parliament with information on its performance and efficiency. Following our preliminary work, we decided to proceed with a full value-for-money audit of the Board. We examined the Board's evaluation of the impact of federal regulation on patented drug prices, the implementation of the legislative framework and the way the Board regulates the prices of patented medicines sold in Canada. The audit focussed on the Board's reporting of results, its price review activities, and its reporting of drug price trends and spending on pharmaceutical research and development. We also looked at certain aspects of the Board's administration. Further details on the audit scope, objectives and criteria are presented at the end of the chapter in **About the Audit**.

Observations and Recommendations

Impact of Federal Regulation of Patented Drug Prices

Average annual increases in prices of patented medicines have moderated

17.23 From 1982 to 1987, annual price increases of pharmaceutical drugs were proportionally higher than annual increases in the Consumer Price Index (CPI). After 1988, the drug price trends reported by the Board show an overall decline in the annual growth of patented drug prices relative to the CPI.

17.24 From 1988 to 1997, the average increase in the CPI was approximately 2.8 percent per year, while the Board's Patented Medicine Price Index (PMPI), an index of manufacturers' prices for patented drugs, increased at an average rate of about 1.0 percent per year. The rate of annual change in the PMPI was also lower than the average increase in the pharmaceutical component of the Industrial Product Price Index (an index that includes both patented and non-patented drugs), reported by Statistics Canada at 2.2 percent during the same period (Exhibit 17.3).

Exhibit 17.3 is not available, see the Report.

The Board has contributed to containing the prices of patented medicines

17.25 Based on our review, it is evident that the Board has exerted a constraining influence on the prices of patented medicines sold in Canada. The decline in the rate of patented medicine price increases relative to the CPI began after 1988 and coincides with the federal regulation of patented drug prices.

17.26 The overall decline in the rate of annual price increases compared with the CPI is to be expected, because the Board's guidelines stipulate that the price of an existing patented drug product should not increase by more than the CPI. However, the evidence also suggests that factors other than price regulation have exerted a moderating influence on patented drug prices.

Other factors have contributed to containing the prices of patented medicines

17.27 The Board's data indicate that between 1991 and 1994, on average the prices of more than half of the 200 top-selling patented drug products in Canada either remained constant or fell, while the CPI continued to rise (Exhibit 17.4).

Exhibit 17.4 is not available, see the Report.

17.28 It is not clear from currently available information how these pricing patterns would automatically be the consequence solely of the Board's activities. If federal price regulation were the sole factor in price containment, then the prices of patented medicines could be expected to grow to the maximum permitted under the Board's guidelines on excessive prices. That they have not done so implies that factors other than the Board's activities also need to be taken into account.

17.29 A number of provincial governments have taken steps to control their health-related expenditures. As indicated by the Board itself, federal regulation of prices and provincial cost-containment measures have resulted in complementary policies to control drug prices and costs.

17.30 Another factor that could also have had an effect on the prices of patented medicines is the increased market penetration of patented drug manufacturers as a result of the elimination of compulsory licensing and the extension of the period of market exclusivity. The influence of private health insurance programs is yet another factor.

The Board needs to improve its measurement of the effectiveness of its activities

17.31 In a regulatory program of this type, the budgetary expenditures are quite small compared with those of most federal programs. However, the impact of price regulation in this area is potentially very significant. Price regulation can have an impact on levels of profitability and levels of investment in the pharmaceuticals sector, on the cost of the Canadian health care system and on the welfare of the Canadian public.

17.32 The Board has taken steps to assess the impact of federal regulation of patented drug prices. In February 1997, it published its study entitled "The Impact of Federal Regulation of Patented Drug Prices". This evaluation

examined the impact of federal price regulation of patented drugs in achieving savings to the Canadian health care system.

17.33 The Board's study found that from 1988 to 1995, the federal regulation of drug prices resulted in estimated total savings to the Canadian health care system of between \$2.9 billion and \$4.2 billion. The estimates were derived from assumptions of what prices would have been and how much more would have been spent on patented drugs in Canada in the absence of federal price regulation. The Board indicated to us that as part of its evaluation process, it had submitted its study to external review before finalizing it.

17.34 We would expect the Board's evaluation to situate its activities clearly in the context of other policy developments influencing the levels of patented drug prices. Further, we would expect the Board to provide a perspective on how these other activities would impact on its own results.

17.35 The Board's study acknowledged that provincial cost-containment measures have resulted in complementary policies to control prices and costs. However, the Board's measurement of savings did not assess the possible effects of provincial measures. Similarly, the Board did not attempt to take into account the possible impact on prices resulting from the discontinuing of the previous system of compulsory licensing. Based on the finding in Exhibit 17.4 that federal price regulation is not the sole constraining influence, along with the Board's own recognition that other factors are involved, we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated.

17.36 We believe that the Board needs to use better evaluation methods to take these external factors into account when it measures the actual impact of its activities. The Board's evaluation report states that it is difficult to assess what portion of the impact estimated in its study might be attributable to the activities of provincial governments and other purchasers to control their expenditures. However, our audit work identified a possible approach to addressing some such issues, based on a 1992 study undertaken by the United States General Accounting Office. In our judgment, such an approach would be a cost-effective means to assist the Board in improving the measurement of its effectiveness and better informing Parliament of the results achieved.

17.37 In our view, it is essential that Parliament obtain information to assist in identifying clearly all those program and policy initiatives that affect the achievement of the government's objectives. We urge the Board to improve its measurement of its effectiveness — both for purposes of accountability to Parliament and to assist decision makers in improving the program.

17.38 The Patented Medicine Prices Review Board should improve its approach to measuring the effectiveness of its activities, taking into account other factors that have an impact on patented drug prices.

Board's response: The Board welcomes the Auditor General's encouragement of its efforts to evaluate its impact and it will continue to seek ways of improving the measurement of its effectiveness. It will also continue its recent work to assist in the evaluation of provincial and other policies at the request of the task forces established by the federal/provincial/ territorial ministers of health.

Reporting of results to Parliament also needs improvement

17.39 The Board has reported its evaluation findings on its activities to Parliament. The findings were reported as part of the Improved Reporting to Parliament Initiative covering the period ended 31 March 1997, and as part of the Board's submission on 4 March 1997 to the Standing Committee on Industry during the Committee's review of the *Patent Act*.

17.40 As we have noted, the Board's evaluation report acknowledged the tentative nature of the \$2.9 billion to \$4.2 billion range of savings as the result of its price regulation activities. However, in reporting this result to

Parliament, the Board did not provide a clear perspective on the limitations of its estimates and did not indicate that the effects of other factors should also be considered on the level of savings it specifically attributed to federal price regulation. When it is receiving performance information from departments and agencies on results achieved, Parliament needs to be provided with a realistic perspective on the reliability of the information.

Legislative Framework

The Board's role and scope of jurisdiction are not widely understood

17.41 The Board receives many complaints from the public about drug prices every year. In many of these cases, the drugs in question are non-patented drugs, outside the jurisdiction of the Board. A perception exists that the Board regulates the prices of all drugs.

17.42 Although the Board is required to report trends in the prices of all drugs, it is not within its jurisdiction to regulate the prices of generic drugs, drugs that have never been patented, and drugs whose patent has expired. Further, the Board regulates only the price at which the patentee sells the medicine; this is usually the price charged by the manufacturer to a wholesaler or directly to a hospital or pharmacy. In addition to the manufacturer's price, the retail cost of a prescription or over-the-counter drug includes distribution costs, mark-ups and applicable dispensing fees, none of which the Board regulates. Thus, only one of the components making up the price paid by consumers is subject to the Board's regulation.

17.43 An environmental scan undertaken by the Board in 1995 found a low level of public awareness about its role. Several stakeholder groups suggested that the Board needed to examine its communications strategy.

17.44 In addition to public consultations, the Board has issued a number of publications and newsletters and has placed information on the Internet to keep interested parties informed of its work. However, it recognizes that many organizations and individuals remain unfamiliar with its role.

17.45 The lack of general public knowledge about the Board leaves a significant expectation gap between what it actually does and what the public expects that it does to regulate prices of medicines and protect consumers. We encourage the Board to continue to improve its communications and, where possible, to use other vehicles or stakeholders as part of its communications strategy to enhance public awareness of its work.

17.46 At the time of our audit, the Board had initiated a consultation process with stakeholders to examine its role, functions and methods with a view to increasing its relevance to the needs of those it serves. We are fully supportive of this initiative.

17.47 **The Patented Medicine Prices Review Board should continue to identify opportunities to use other vehicles or stakeholder groups as part of its communications strategy to enhance public awareness of the activities for which it is and is not responsible.**

Board's response: The Board agrees and is encouraged to note the Auditor General's support of its current initiatives.

Inherent difficulties in the legislative framework

17.48 As we have noted, the PMPRB was established through amendments to the *Patent Act*. The Act and the Patented Medicines Regulations together set out the legislative framework for the federal system of price regulation and its administration by the Board. We expected that the Board would take the necessary steps to ensure

compliance with the legislation and regulations, and would enforce them. Where the legislative framework posed constraints on its ability to fulfil its mandate, we expected the Board would propose that changes to legislation and regulations be considered.

17.49 We observed that some requirements in the legislation and regulations are difficult to apply in practice, and a review of their continued relevance needs to be considered. In addition, the legislation is silent or unclear on some issues. This has hindered the Board's ability to fulfil its mandate.

17.50 Price factors. The legislation requires the Board to consider four factors in determining whether a patented medicine is sold in Canada at an excessive price. These factors include the price of the drug in Canada and its price in other countries. However, the factors are not well defined in the legislation or regulations.

17.51 The regulations specify the information that patentees are required to provide, with different requirements for Canadian prices and foreign prices. For sales in Canada, this includes the publicly available ex-factory price as well as the average price per package of the medicine to each class of customer (wholesalers, hospitals and pharmacies) net of discounts, rebates and free goods, or total net revenues for all package sizes of the medicine. For foreign prices, the regulations require only the publicly available ex-factory price to each class of customer in seven specified foreign countries.

17.52 In applying its guidelines to determine excessive prices, the Board compares net average transaction prices in Canada with average foreign ex-factory prices, which are not necessarily net of discounts, rebates and free goods. In effect, the Board has interpreted the Act and the regulations to call for comparison of prices that are composed differently.

17.53 In addition, the regulations require the patentee to certify that the information it provides is true and correct. In practice, however, it is difficult to check drug prices in foreign countries. The publicly available foreign ex-factory prices reported by patentees are often not found directly in public reference sources, such as price lists published by foreign governments or pharmaceutical associations. This is discussed further in paragraphs 17.83 to 17.89.

17.54 The legislation also requires the Board to consider the foreign prices of other drugs in the same therapeutic class. However, the Board indicated that it is not practical to address this factor in its guidelines because of the inherent differences in the uses, availability and prices of drugs in foreign countries. As a result, the Board staff feel that it is not possible to meet this requirement of the Act in its initial assessments. However, the Board believes that on the occasions where such a comparison has been required for a hearing, it has been able to meet this requirement.

17.55 Foreign countries. The regulations list seven foreign countries for comparative price information: France, Germany, Italy, Sweden, Switzerland, United Kingdom and the United States. The six European countries have national systems to regulate drug prices or profits that are quite different from Canada's; the United States has no regulatory system that affects the pricing of pharmaceuticals.

17.56 The "basket" of seven foreign countries poses a practical constraint on comparing international drug prices. We found that often it is not possible to make a meaningful comparison between the Canadian price of a patented drug and its prices in the seven foreign countries. Our analysis of the Board's data showed that in approximately 20 percent of the cases, the only foreign country selling the same drug was the United States, which has the highest drug prices overall.

17.57 Patent dedication. Between 1989 and 1995, pharmaceutical patentees notified the Commissioner of Patents of more than 130 drug products for which they had surrendered their patent rights and entitlements, in order that other manufacturers could benefit from their use before the term of the patent expired.

17.58 The *Patent Act* is silent on this “dedication” of patents and on the Board’s jurisdiction over products whose patents are dedicated for public use. However, as stated in its 1991 annual report, the Board took the position that drug products with patents dedicated for public use would cease to be subject to its review.

17.59 Subsequently, the Board realized that patent dedication had become a serious problem. It was concerned that patentees may have used this practice to avoid having the product subject to the Board’s price review. The Board’s analysis revealed that at least 43 of these products were priced above its guidelines, resulting in a cost to Canadians of nearly \$40 million in the period from 1 January 1989 to 1 July 1995.

17.60 In October 1995, having obtained legal advice, the Board changed its practice to assert jurisdiction over drug products whose patents have been dedicated, believing that an argument could be made that these products do fall within the Board’s jurisdiction. The Board believes that the new policy is based on a correct interpretation of the Act, and says that it is confident this policy will be upheld in the courts should it be challenged.

17.61 In a 1996 ruling on one case, the Federal Court of Appeal noted, “That the Act makes no express provision for the possibility of patent dedication is at least one other complication that will have to be dealt with at some future date.” As the Act remains silent on this issue, we believe that clarification in the legislation would be useful to guard against potential challenges to the Board’s practice.

17.62 The Board decided that it would not retroactively assert jurisdiction over products whose patents had been dedicated before 30 January 1995. However, it maintains that it has the discretion to investigate complaints about the pricing of these products, should it decide to do so. There is no standard or set of factors established for the Board to consider in the exercise of this discretionary power. In our view, such a standard would need to be in place to avoid any perception of arbitrary conduct by the Board.

17.63 Voluntary compliance undertakings. As a quasi-judicial body, the Board can determine whether a price is excessive and can issue a remedial order only after following a public hearing process. When the Board finds that the price of a patented drug is excessive, it can order the patentee to lower the price and, in order to offset the excess revenue the manufacturer has received, to make further price reductions or remit an amount to the Crown. The legislation states that the Minister of Health can enter into agreements to distribute to provinces the money collected through these orders.

17.64 Where excessive price is suspected, the Board has adopted a policy of using voluntary compliance undertakings in lieu of holding a public hearing. (Since 1993 the Board has completed one such hearing.) If the Board confirms through an investigation that the price of a patented medicine exceeds the guidelines, before a public hearing takes place the patentee can make a voluntary compliance undertaking to adjust the price of the drug and to offset excess revenues, including making a payment to the Crown. Such an undertaking does not constitute an admission that the price of the drug product is excessive.

17.65 We found that this practice has certain merits. The approval of voluntary compliance undertakings can avoid time-consuming and costly formal proceedings. However, the *Patent Act* does not address their use; hence it does not authorize the Minister of Health to give the provinces funds collected through undertakings.

17.66 Between 1993 and 1996, the Board accepted 14 voluntary compliance undertakings and collected \$10.2 million from drug manufacturers. In the absence of legislative authority to distribute such money to the provinces, Health Canada had to obtain approval in 1997 for a grant to distribute the \$10.2 million to provinces and territories. No legislative amendment has been proposed to provide for future distribution of money collected through voluntary compliance undertakings.

17.67 Pharmaceutical research and development expenditures. The Act requires the Board to report on its estimate of research and development (R&D) spending in relation to revenues from sales of medicines in Canada, by

individual patentee and for all patentees in total. The legislation gives the Board substantial powers, including the power to issue an order requiring a patentee or any person to provide this information.

17.68 The R&D expenditures in question are those that are eligible under the federal tax legislation that was in effect on 1 December 1987. While the applicable federal tax regulations have changed in the past decade, no corresponding changes have been made to the Patented Medicines Regulations.

17.69 It is difficult for the Board to check the accuracy of reported R&D expenditures, which are based on 1987 federal tax regulations. The R&D information reported by the Board is essentially based on information certified by the patentees to be true and correct. Given that the Board's procedures to check the information are limited, so is its assurance that the information is complete and accurate. The Board's annual report contains no such caveats.

17.70 On the basis of information submitted by patentees, the Board reported that the brand name pharmaceutical industry had met its commitment to increase annual R&D spending to 10 percent of sales by 1996.

17.71 Given that this commitment has been met, there is a need to review whether the reporting of pharmaceutical R&D expenditures continues to be relevant. Should the Board continue to report this information, there is a need to assess whether there are more cost-effective means of obtaining and reporting these data, considering the limited resources of the Board.

17.72 Some of the weaknesses we noted could be addressed through amendments to the legislation, or through regulation where the *Patent Act* permits.

17.73 **The Patented Medicine Prices Review Board should, in consultation with Health Canada and Industry Canada, bring to the attention of the government the need to review the legislation and regulations relating to patented medicines in order to:**

- **examine the relevance of the price factors as well as the use of comparisons with prices in the foreign countries listed in the regulations;**
- **clarify the jurisdiction of the Board over patented medicines whose patents are dedicated for public use;**
- **address the future distribution of money collected through voluntary compliance undertakings; and**
- **review the continued relevance of the requirement for reporting pharmaceutical research and development expenditures.**

***Board's response:** The Board is currently consulting with stakeholders on issues within its jurisdiction such as its price methodologies, the calculation of foreign prices, and the application of the guidelines in cases where the drug is only sold in a small number of countries. If the Board concludes that changes to the legislation or regulations are required in order to fulfil its legislative mandate, it will make recommendations to the government. The Board is also vigilant in watching for evidence of practices, such as patent dedication, to avoid its jurisdiction and will recommend that anti-avoidance measures be incorporated in the Act if necessary. The Board will bring the other aspects of this recommendation to the attention of the appropriate ministers and is prepared to work with them.*

Review of Prices of Patented Medicines

Most patented drug prices comply with the Board's guidelines

17.74 The core activity of the Board is to ensure that the prices charged by manufacturers of patented medicines are not excessive. Exhibit 17.5 depicts the processes for reviewing introductory prices of new patented medicines and reviewing prices of patented drugs that are already on the market. In 1997, a total of 991 different patented medicines were sold in Canada; 98 of these were new drugs introduced during the year.

Exhibit 17.5 is not available, see the Report.

17.75 According to the Board's 1997 data, most patented drugs sold in Canada comply with the Board's guidelines on excessive prices. Approximately 85 percent of the new and existing patented drugs were considered to be priced within the guidelines. Only approximately two percent of the drug products whose prices appeared to exceed the guidelines were being investigated or were subject to further review. The Board will commence an investigation only when certain criteria are met (Exhibit 17.6). About 13 percent had prices that exceeded the maximum level established by the guidelines, but the excess revenues were deemed too small to warrant an investigation.

Exhibit 17.6

Criteria for Initiating a Price Investigation

For existing drug products:

- A price is 5% or more above the maximum non-excessive price and there are cumulative excess revenues of \$25,000 or more over the life of the patent after 1 January 1992.
- Cumulative excess revenues are \$50,000 or more over the life of the patent after 1 January 1992.
- Complaints with significant evidence are filed.

For new drug products:

- The introductory price is 5% or more above the maximum non-excessive price.
- Excess revenues in the introductory period are \$25,000 or more.
- Complaints with significant evidence are filed.

Source: Patented Medicine Prices Review Board

17.76 In its 1997 annual report to Parliament, the Board reported that the products in the latter group were within the guidelines, although consumers had paid prices higher than the established maximum. The prices either exceeded the maximum annual price increase allowed in relation to changes in the CPI or, in a few instances, were the highest among the seven foreign countries. The total cumulative excess revenues or cost to consumers of these products together amounted to approximately \$1.2 million at 31 December 1997. In our view, it is not appropriate to report these products as priced within the guidelines.

Need to ensure that price review decisions are clear and transparent

17.77 The Board's guidelines are not a rigid set of decision-making rules and are not binding on the Board. However, we expected that established guidelines would be applied rigorously and consistently, and that the reasons for exceptions or non-application of the guidelines would be clear and transparent.

17.78 We found that guidelines were generally applied rigorously. However, we observed a small number of cases where prices exceeded guidelines but the Board's reasons for making exceptions or not applying the guidelines were not clear or transparent.

17.79 In one such case, the Board decided not to commence proceedings under the Act on the grounds that, given the cost of holding a public hearing, it would serve no useful purpose. The cumulative excess revenues amounted to approximately \$52,000 at the time this decision was made. However, the Board's files contained no reference to any threshold and no indication as to what level of excess revenues would trigger further action. The Board's 1997 data show that the cumulative excess revenues for this product, which is still on the market, have exceeded \$157,000.

17.80 In another case, the international price comparison guideline was not applied to limit the introductory price of a new drug product. In this case, the Board staff closed the investigation even though the guidelines stipulate that the price of a patented drug in Canada can at no time exceed those in the foreign countries. Since 1995 this product has had a higher price in Canada than in other countries and is still being sold here. Had the guidelines been applied, the Board's analysis shows that the cumulative excess revenues would have amounted to approximately \$4.896 million in the period from March 1995 to December 1996.

17.81 In a case in 1993, the Board decided to proceed with a public hearing concerning a drug in a particular category. However, having received submissions from the parties involved, the Board accepted a voluntary compliance undertaking whereby the patentee agreed to pay \$1.755 million to the Crown to offset excessive pricing. But the guidelines for that category of drug were not applied in determining the amount to be paid in the undertaking. Had the Board applied the guidelines for that category of drug, the amount paid would have been several times higher. The Board issued reasons for accepting the undertaking, but provided no adequate explanation of the basis on which the payment was calculated.

17.82 **The Patented Medicine Prices Review Board should ensure that its guidelines are rigorously applied, or are revised if they are considered inappropriate. The Board should also ensure that in cases where exceptions are made or its guidelines are not applied, the reasons for and effects of its decisions are clear and transparent.**

Board's response: We agree. The Board is currently consulting on matters that may warrant further revisions to its guidelines and on how it may provide more information with respect to its price review activities.

The Board notes that the Auditor General found that the guidelines are generally applied rigorously. As he has noted, the Board cannot, by law, be bound by its guidelines. The three cases referred to in the chapter were handled in conformity with the Act; the Board made no finding of excessive pricing following its investigations. The Board agrees, however, that it should try to find ways consistent with the law and principles of fairness to report more information on the outcome of investigations.

The Board relies on price information that often it cannot check for accuracy

17.83 As we have noted, there are inherent difficulties in checking the drug price information filed by patentees.

17.84 The Board relies on companies themselves to report the price information. The Board staff expends considerable effort attempting to check its accuracy. They compare the foreign price information with publicly available reference sources and with the previous year's prices to check the reasonableness of the information. If a formal investigation is required, the Board staff will also attempt to contact foreign authorities to verify the prices.

17.85 In 1997, the Board contracted a firm to undertake a limited review of foreign drug price information filed by patentees. The review found, as would be expected, that the prices submitted by patentees were, on average, below the wholesale or retail prices listed in the public reference sources. However, it could not verify that prices filed were indeed the manufacturers' prices.

17.86 The Board has recognized the need to validate foreign price information. It continues to discuss this with foreign authorities and has initiated steps to review a sample of the prices at which patented drugs are sold to foreign wholesalers and pharmacies. The Board noted that it has not attempted to check manufacturers' prices to hospitals in foreign countries because the information is often not publicly available.

17.87 The Board receives domestic price information from the pharmaceutical companies and, in most cases, accepts the information as accurate. The Board relies on this information in determining whether or not prices charged by the companies are excessive. The Board staff conducts some reviews to identify anomalies and inconsistencies in an attempt to check the accuracy of the price data, but does not do a systematic check on a regular basis.

17.88 The Board essentially relies on companies themselves to report the data on which the regulation of their drug prices is based. We would expect that the Board would attempt to do more to obtain a reasonable level of confidence in the accuracy of the data.

17.89 We believe that the Board needs to identify cost-effective means to check the accuracy of the price information in order to enhance public confidence in its price review work. For example, patentees could have their price information certified as part of their annual audit.

17.90 **The Patented Medicine Prices Review Board should, in performing its price review work, identify cost-effective means to check the accuracy of price information submitted by patentees.**

Board's response: The Board agrees that it is essential to ensure public confidence in its price review work and to ensure compliance with the Act. The Act provides significant penalties for failure to file accurate information, including jail terms and fines up to \$25,000 per day. Although the Board has no evidence of wrongdoing, it will continue to seek out cost-effective means to verify price information.

Co-ordination of scientific reviews of new drugs needs to be strengthened

17.91 The Board conducts scientific reviews to categorize new drugs for price review purposes. The category assigned will affect the introductory price of the new medicine.

17.92 The scientific reviews of new drug products entail obtaining detailed information on drug products from the manufacturer and using the recommendations of an independent, three-member drug advisory panel. Where necessary, the panel considers advice from other experts.

17.93 Approximately seven percent of new drugs are categorized as a category 2 — a “breakthrough”, or a drug that provides a substantial improvement over comparable existing products. Only the advisory panel can recommend that a new drug product be considered a category 2 drug.

17.94 Health Canada is responsible for approving drugs for sale in Canada. The Department ensures that the drugs available are safe, effective and of high quality. Prompted by the urgent need to provide Canadians with the best available therapies for serious and life-threatening diseases, the Department has introduced a policy for the priority review of drug submissions. The Department grants a priority review status to drug submissions that meet either of the following criteria:

- there is substantial clinical evidence that the drug provides effective treatment, prevention or diagnosis of a disease or condition for which no drug is presently marketed in Canada; or
- there is substantial clinical evidence that the drug provides significantly improved efficacy or significantly diminished risk over existing therapies, preventatives or diagnostic agents for a disease or condition that is not adequately managed by a drug marketed in Canada.

17.95 Health Canada grants priority review status prior to a full review of the data package; the review might demonstrate that in fact the drug does not provide the significant advance anticipated. While the Board and Health Canada have different objectives, they both attempt to determine whether a drug provides significant improvement over existing therapies. We observed cases that met Health Canada's criteria but that were nonetheless categorized by the Board as drugs that do not provide substantial improvement over comparable existing products.

17.96 We believe that the Board needs to explore opportunities to share information with Health Canada, to the extent practical.

17.97 The Patented Medicine Prices Review Board should explore opportunities to improve the co-ordination of its work with Health Canada in performing scientific reviews to categorize new patented medicines.

Board's response: The Board and Health Canada have regular contacts and share a good deal of information; we will continue to review our requirements and enhance these arrangements as necessary. Nonetheless, these agencies have different responsibilities and it is essential that any "co-ordination" not constrain the Board's duty to determine, in a public hearing, if a price is excessive.

Reporting of Drug Price Trends

Improvements required in reporting of drug price trends

17.98 The Board is required to submit an annual report to Parliament that includes a summary of pricing trends for all drugs, both patented and non-patented. We expected that the Board would report complete, relevant and reliable information on drug price trends, supported by adequate analysis.

17.99 The Board has developed a Patented Medicine Price Index to report on price trends for patented drugs. The index measures the change in aggregate prices of all patented drugs that are on the market during at least two consecutive six-month periods.

17.100 As the Board does not have jurisdiction over prices of non-patented drugs and lacks information on them, it has to resort to other sources of information. Since 1996, the Board has used the Industrial Product Price Index (IPPI) published by Statistics Canada to derive a Non-Patented Medicine Price Index (NPMPI).

17.101 The Industrial Product Price Index for pharmaceuticals is a monthly index that measures price changes of major patented and non-patented drugs sold in Canada, as well as exports of drug products produced in Canada.

17.102 We identified differences between the Board's patented and non-patented drug price indices and those published by Statistics Canada. The Board reported that the Non-Patented Medicine Price Index showed an annual growth of 2.5 percent in 1996 and a decline of 1.3 percent in 1997. However, in its corresponding index, Statistics Canada reported a growth of only 0.1 percent in 1996 and a decline of only 0.4 percent in 1997. The Board did not use Statistics Canada's non-patented medicine price sub-index because it found it unreliable. However, it is part of the Industrial Product Price Index, which the Board does include in its annual report.

17.103 Although Statistics Canada has updated its IPPI to use 1992 as the base year, the Board did not show the revised IPPI figures in its 1997 annual report. We urge the Board to work with Statistics Canada to improve the reporting of drug price trends and to minimize any potential duplication of effort.

17.104 The Patented Medicine Prices Review Board should work with Statistics Canada to improve the reporting of drug price trends.

Board's response: The Board has always discussed methodological and other issues with Statistics Canada but agrees that more can be done to improve the reporting of drug price trends in Canada. It has recently established a task force with representatives of Statistics Canada for that purpose.

Board Administration

An appropriate financial control framework is in place

17.105 We assessed the financial management capability of the Board, including its financial control framework. In our view, the Board has most of the important features of financial control for an agency of its size and financial complexity, with financial management capabilities focussed primarily on meeting central agency requirements. It has a control framework in place to ensure that money is spent in accordance with applicable authorities.

17.106 Approximately 70 percent of the Board's annual expenditures of approximately \$3 million are related to payroll costs. The remainder is spent mainly on contracting for legal and professional services and on other administrative expenditures. We identified a few cases where the Board had entered into contracts contrary to government contracting regulations. For example, it gave contracts valued at over \$25,000 each to one firm and one individual on a non-competitive basis. However, nothing of a significant nature has come to our attention to indicate that expenditures were not properly incurred.

Conclusion

17.107 The Patented Medicine Prices Review Board regulates the prices of patented medicines in accordance with the *Patent Act* and the associated regulations, with the exception of some requirements in the legislation and regulations that are difficult to apply in practice. Consideration needs to be given to reviewing the continued relevance of those requirements.

17.108 Most patented drugs comply with the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by patentees.

17.109 The Board has taken steps to assess the impact of federal regulation of patented drug prices. Several factors other than the Board's activities also influence the price of patented medicines, but the Board's measurement of its impact did not assess the effects of these other factors. In reporting to Parliament, the Board did not clearly identify the limitations of the estimates of its impact. As it continues to measure its effectiveness, it is important that the Board identify the results that are attributable solely to its activities.

17.110 The Board has developed price indices to report to Parliament on price trends for patented and non-patented drugs. However, it needs to work with Statistics Canada to improve the reporting of drug price trends.

17.111 The Board reports to Parliament on pharmaceutical research and development expenditures essentially on the basis of information filed by patentees. Given that the Board's procedures to check the information are limited, so is its assurance that the information is complete and accurate.

17.112 Finally, with respect to its administration, the Board has most of the important features of financial control for an agency of its size and financial complexity, with financial management capabilities focussed primarily on meeting central agency requirements.

About the Audit

Objectives

- To determine whether the Patented Medicine Prices Review Board regulates the prices of patented medicines in accordance with relevant legislation and regulations.
- To determine whether the Board reports to Parliament complete and reliable information on:
 - the extent to which its price review activities affect prices of patented medicines;
 - price trends for all drugs; and
 - research and development spending by pharmaceutical patentees.
- To determine whether the Board manages its operations efficiently in the areas of administrative expenditures, contracting and human resources.

Scope

The audit examined the Board's price review activities and its reports on drug price trends, research and development spending by pharmaceutical patentees, and the impact of federal regulation of prices of patented medicines. We analyzed in detail a sample of price submissions for 80 drug products. We also examined the Board's compliance and enforcement activities involving investigations and voluntary compliance undertakings. We had extensive discussions with the Board staff and observed the Board's ongoing consultation with stakeholders during the audit. In addition, we reviewed various studies and reports published by the Board and other documentation.

The audit did not examine the approval of drugs, granting of patents and the Patented Medicines (Notice of Compliance) Regulations. These areas are outside the Board's jurisdiction.

The quantitative information in this chapter that has been drawn from government sources or the Board's data bases has been checked for reasonableness but has not been audited.

Criteria

We expected that:

- The Board would clearly identify and communicate its role and mandate to stakeholders.
- There would be established practices for the review of prices of patented medicines, in compliance with the legislative and regulatory framework.

- Legislation and regulations would be complied with and enforced.
- Where the legislation and regulations pose constraints for compliance and enforcement, changes to legislation and regulations would be proposed where necessary.
- Established guidelines and price review methodology including criteria for making exceptions would be sound, clear and consistently applied.
- Review of prices of patented medicines including scientific reviews, verification of data submitted by patentees, price comparisons, investigations, enforcement and remedial actions would be efficient and effective, in compliance with authority and established policy and guidelines.
- The price review process including decisions on investigations and voluntary compliance actions taken would be transparent to the public.
- Judicial proceedings would be conducted consistent with legislation and established rules for the practices and procedures of the Board.
- There would be established procedures to measure performance and report results. Parliament would be provided with relevant, reliable and understandable information on the performance of the program, including intended and unintended effects of the Board's price review activities.
- The Board would report complete, relevant and reliable information on pricing trends in the pharmaceutical industry, supported by adequate analysis.
- The Board would report complete and reliable information on the ratio of research and development expenditures to sales revenues for individual pharmaceutical patentees and for all pharmaceutical patentees as a whole, supported by adequate analysis.
- The Board would have the financial management capability it needs to meet its responsibilities, including appropriate controls to ensure that expenditures for goods and services are incurred properly and payments pursuant to remedial actions are collected as authorized.
- The Board would have established sound practices to manage its human resources.

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Chapter 18

**The Financial Information Strategy:
A Key Ingredient in Getting
Government Right**

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The Financial Information Strategy: A Key Ingredient in Getting Government Right

Main Points

18.1 Under the Financial Information Strategy (FIS), the government is making sweeping changes in the type of financial information provided to decision makers. FIS involves the move to full accrual accounting similar to that used by business firms, the implementation of new financial systems and the integration of full accrual financial information into day-to-day decision making of departmental managers. When fully implemented, by 2001 according to the current plan, FIS should help the government strengthen significantly its management of business lines and its accountability to Parliament. The government has clearly indicated that it is committed to *getting government right* and has established FIS as one important initiative in doing this. The Office of the Auditor General fully supports the stated objectives of FIS.

18.2 FIS began a decade ago. Progress in the early years was slow, but in recent years the tempo of work has picked up. To date, FIS has focussed on implementing new departmental financial systems that are Year 2000-compliant and on ensuring that departmental and central systems will provide appropriate information to include in the government's annual financial statements.

18.3 However, the government has yet to implement its plans to deal with the important area of making full accrual financial information available to officials within departments and agencies who manage business lines and related components on a day-to-day basis. One of the objectives of FIS is to provide officials with more complete information on costs to compare with results achieved when making key decisions. Until this is done, the full benefits of FIS will not be realized.

18.4 While better cost information for decision making is a benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of FIS implementation, which could be significant.

18.5 The government and Parliament can help ensure the success of FIS by appropriating funds on a full accrual basis, so that accountability and reporting are on the same basis. But central agencies and individual departments must also act to help ensure that the full benefits of FIS are achieved. Central agencies must secure complete departmental "buy-in", and deputy ministers of individual departments must put in place the necessary infrastructure, including appropriate systems and human resources.

18.6 Departments face a major challenge in completing the renewal of their financial systems to meet the objectives of FIS. Best practices and lessons learned from others who have gone before can help achieve success.

18.7 Given the massive scale of financial systems renewal now under way to meet the Year 2000 challenge, we believe that there is a unique opportunity to put FIS in place by the 2001 target implementation date. This is not a simple task. To obtain the full benefits of FIS and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to track the government's progress in implementing FIS and achieving these benefits.

Introduction

Getting government right

18.8 In his 1994 Budget, the Minister of Finance announced Program Review “to ensure that the government’s diminished resources are directed to the highest priority requirements and to those areas where the federal government is best placed to deliver services.” In the 1995 Budget, the Minister explained that Program Review would lead to long-lasting structural change in *what* the government does. He spoke in terms of *getting government right*.

18.9 In 1995, the President of the Treasury Board announced a new Expenditure Management System (EMS) to ensure that the scrutiny of government spending initiated under Program Review became a permanent feature of public sector management. To operate in this new environment, government managers and parliamentarians alike need reliable information to help them assess and scrutinize the efficiency and cost effectiveness of ongoing activities. To help meet this need, the Minister of Finance announced in his 1995 Budget, “the government intends to adopt ‘full accrual accounting’, which is comparable to private sector practice.” He further noted, “This change will better enable the government to report the true cost of programs and improve accountability.”

18.10 The government’s Financial Information Strategy (FIS) is one of the key vehicles being used to put these changes in place. The 1997 report of the President of the Treasury Board, entitled *Getting Government Right*, stated that FIS “is intended to lead to a model for financial management and accounting comparable to the private sector.” The government’s current vision, mission and tactics for the implementation of FIS are described in Exhibit 18.1. In our view, some significant implications of FIS involve the move to full accrual accounting practices similar to those used by business firms, the implementation of new financial systems throughout government and the integration of full accrual financial information into day-to-day decision making of departmental managers. The Appendix to this chapter provides more information on the historical background leading to FIS.

Exhibit 18.1

FIS Vision, Mission and Tactics

Vision

The vision for FIS is to enhance the government’s decision making and accountability, and to improve organizational performance through the strategic use of financial information.

Mission

The Financial Information Strategy is to be fully implemented by the year 2001, in order to:

- better support program review, business planning, budgeting, expenditure management, and other management and decision making processes; and
- facilitate accountability for program and financial results by enabling improved estimates and performance reporting to Parliament.

Tactics

In order to achieve the mission, the Financial Information Strategy will:

- change the basis of accounting from the current modified accrual basis to full accrual accounting, including the capitalization of fixed assets;

- implement a new chart of accounts for government-wide reporting;
- decentralize accounting to departments, with the Receiver General continuing to undertake the government's treasury function and produce the consolidated government-wide financial statements;
- allocate the responsibility for payment scheduling to departments;
- modernize the central accounting system by developing the Central Financial Management Reporting System (CFMRS);
- improve departmental systems to include integrated financial and materiel processes, and to take advantage of new technology; and
- foster a learning environment in which managers steadily improve their ability to use quality financial information for strategic purposes.

Source: FIS: A Summary, January 1997

18.11 FIS was formally approved nearly a decade ago, was revitalized in 1995 and now has a target implementation date of 2001. As Exhibit 18.2 illustrates, the quality of financial information within the federal government, for both management and accountability, continues to be significantly below acceptable standards in the private sector. Getting government right in the years ahead will require that this disparity be eliminated.

Exhibit 18.2

Private Sector, Federal Government and Proposed FIS Practice

	Private Sector Practice	Federal Government Practice	Planned Under FIS
Government-wide financial information			
• Financial statements that report all assets and liabilities	Yes	No	Yes
• Monthly financial statements on the same basis as the annual statements	Yes	No	Yes
• Annual financial statements available soon after the fiscal year end	Yes	No	Yes
• Annual financial statements that are audited	Yes	Yes	Yes
Departmental financial information			
Complete, accurate, relevant and timely financial information, for example:	Yes	Ad Hoc	Yes
• to set prices and fees or to recover costs;	Yes	Ad Hoc	Yes
• to assess stewardship of assets and liabilities;	Yes	Ad Hoc	Yes
• to assess efficiency and cost effectiveness of operations;	Yes	Ad Hoc	Yes
• for use in selling or restructuring operating units; and	Yes	Ad Hoc	Yes
• for lease versus buy decisions.	Yes	Ad Hoc	Yes

18.12 In his 1997 annual report entitled *Accounting for Results*, the President of the Treasury Board noted that in order to demonstrate accountability to taxpayers, “the government needs the capacity to measure activities (outputs) and results ... and to link these both to results commitments and to the **resources used.**” (*emphasis added*) Furthermore, he noted in his report that FIS “aims to enhance government decision making and accountability and to

improve organizational performance by providing more complete information on the **costs of programs and activities.**” (*emphasis added*)

18.13 These statements highlight the importance and high expectations being placed by the government on FIS. We agree with the government that FIS is an important initiative in getting government right. This chapter is the first in a series of chapters on FIS over the next few years that aim to provide Parliament with an independent reporting on its development and implementation.

A 35-year call for improved financial information

18.14 For 35 years, there has been a common call for improvements in financial information to support government decision making. Exhibit 18.3 describes some of the key recommendations of the various reviews that have taken place. The scope of FIS was broadened in 1995 from an initial focus on the government-wide needs of central agencies to include improvements in financial information for management and accountability within individual departments and agencies.

Exhibit 18.3

Previous Calls for Financial Information Reform

1962 - Royal Commission on Government Organization (Glassco Commission)

“An accounting system, capable of facilitating decision making by management, should provide complete costs of activities.”

1979 - Royal Commission on Financial Management and Accountability (Lambert Commission)

“... [that] comprehensive cost-based accounting systems be developed and used in all federal departments and agencies, and that these systems meet the criteria of capturing all costs on a timely and accurate basis and be integrated with costing systems capable of analyzing the data thus obtained.”

1987 - Office of the Auditor General, Chapter 4, Financial Management and Control Study (FMCS)

- Few financial systems provide both financial and operational data.
- Current information for managers tells them where they stand in relation to their budget but NOT the cost-effectiveness of their operations.
- Although operational data are available, they can rarely be related to financial data so as to determine the costs of specific operations.
- The concept underlying financial management is that objectives, results and resources should be linked.

1997 - Independent Review Panel on Modernization of Comptrollership in the Government of Canada

“The Panel believes modern comptrollership is about ensuring that management decision making has the benefit of rigorous, complete and integrated financial and non-financial, historical and prospective performance information as well [as] appropriate advice, analysis and interpretation of this information.”

FIS is a key component of the government’s overall vision of comptrollership

18.15 In response to a recommendation by the Independent Review Panel on the Modernization of Comptrollership in the Government of Canada, the President of the Treasury Board announced in January 1998 that the government had committed itself to modernize its approach to comptrollership — “to move it from a narrow and specialized function to a core responsibility of every manager in the public service.” In its 1997 report, the Panel

described comptrollership as including management decision making and public reporting that is based on integrated financial and non-financial information, the creation of a mature risk management environment, the development of appropriate control systems, and values and ethical practices permeating throughout the organization.

18.16 This view of comptrollership embraces our definition of financial management in a government context, as described in Chapter 2 of our 1997 Report. Exhibit 18.4 is a graphical representation of the relationship of FIS to this vision of comptrollership. Successful completion of FIS is required as a pre-condition to being able to deliver on some of the main elements of modern comptrollership, including public accountability reporting, integrated financial and non-financial performance information for decision making, responsive and appropriate control systems and a mature risk management environment.

Exhibit 18.4 is not available, see the Report.

FIS implementation is a shared responsibility

18.17 The Financial Information Strategy is a huge project that will have an impact on every department and agency of the Government of Canada. Such a project requires leadership, co-ordination and co-operation throughout all of its stages.

18.18 At the centre, the Treasury Board Secretariat has established a FIS Project Office to provide leadership across government by managing and co-ordinating the development and implementation of FIS in departments and central agencies.

18.19 The Receiver General is responsible for the development and implementation of a modernized suite of central systems, including the replacement of the current Central Accounting System, that will support the new departmental financial systems, and will accept the summary-level financial data from departments. These data would then be used to produce the monthly Fiscal Monitor, the annual summary financial statements of the Government of Canada and other government-wide information.

18.20 Departments are responsible for implementing new financial systems within their organizations in a manner that supports the objectives of FIS. Departments are also responsible for the quality of the information that they generate to support their departmental decision making process and that they provide to the centre for preparation of the government's summary financial statements.

Strategic Challenges in Realizing the Full Benefits of FIS

Integration of FIS into departmental management

18.21 As described in the Appendix and in Exhibit 18.3, the common theme in studies of financial management in the Government of Canada over the past 35 years has been the need for improved financial information for parliamentary oversight and management decision making. In this context, management decision making refers to decisions at both the overall government level and the level of the departmental line manager.

18.22 In his 1997 report entitled *Accounting for Results*, the President of the Treasury Board re-emphasized this call for improved financial information for management decision making by noting:

In general, however, existing sources of information do not answer questions about the costs associated with specific results. Although conclusive information linking costs and results is often difficult to obtain, improvements are being made through the government's Financial Information Strategy. The Strategy aims to

enhance government decision making and accountability and to improve organizational performance by providing more complete information on the **costs of programs and activities**. (*emphasis added*)

18.23 The government has clearly placed high expectations on FIS to provide better financial information for management decision making. To support these high expectations, the government is investing significant resources in the FIS initiative. The main emphasis to date has been to implement new departmental financial systems that are Year 2000-compliant and to ensure that these and the associated central systems will eventually provide financial accounting information to meet the new requirements for external reporting under FIS (for example, preparing the government's summary financial statements on a full accrual basis).

18.24 To achieve the broad vision of FIS, the government recognizes the need to enhance an additional area — the use within individual departments and agencies of financial information on the cost of business lines and related components for comparison with results achieved. The new financial systems need to be implemented with an emphasis on providing this improved information for management decision making, both directly and through the integration of these systems with specialized costing systems. If this is not done as part of the initial system design, then additional investment may be required to modify these new systems beyond their current financial accounting focus to ensure that the objectives of FIS are fully met.

18.25 In our future audits, we will assess the progress being made within specific departments in implementing financial systems capable of capturing all relevant costs for key management decision making and in integrating these systems with specialized costing systems capable of analyzing the data captured.

18.26 What needs to be done to ensure that these new departmental systems are implemented in a way that finally answers the call for improved financial information for management decision making? We believe that a major part of the answer lies in the need to establish appropriate incentives for change, by moving to accrual-based appropriations and by obtaining departmental “buy-in”.

Moving to accrual-based appropriations

18.27 As previously described, there has been overwhelming recognition, both internal and external to government, that improved financial information is needed for management decision making. The question of why this need has not been filled over the years remains unanswered. We believe, however, that the root of the problem lies with how ministers and, through them, deputy ministers and their managers are held to account by Parliament.

18.28 Parliament controls the public purse through the granting of supply — setting limits on the amount of money available to managers to *acquire* resources. It does this by approving the *Appropriation Act*, which identifies, by spending authority (vote), the amount of money available to the government. As a result, departmental planning, managing and reporting are primarily concerned with spending money to acquire resources. But governments do not exist to *acquire* resources; they exist to deliver programs and services and, in doing so, they *consume* or *use* resources. For example, a government may acquire a building in a particular year to help deliver a program over many years. In doing so, a portion of the building's cost is consumed each year.

18.29 Accordingly, a far better basis to plan, manage and report departmental operations is to focus on *the cost of resources consumed*, which requires full accrual accounting as envisioned by FIS. Exhibit 18.5 provides an example of the impact of full accrual accounting on departmental managers. As stated earlier, in 1995 the Minister of Finance announced the government's intention to adopt full accrual accounting for the preparation of the annual Budget and for reporting back to Parliament on financial results in the Public Accounts of Canada. In addition, the government has informed us that it intends to ask departments to prepare their Reports on Plans and Priorities and their departmental Performance Reports on a full accrual accounting basis. These annual documents provide financial and non-financial information on departmental plans and priorities for the upcoming year and on performance against these plans after the end of that year.

Exhibit 18.5

The Impact of Full Accrual Accounting on Departmental Decision Making

The biggest change for departmental managers resulting from the move to full accrual accounting will be how physical assets are accounted for. Under current accounting policy, the acquisition of physical assets is treated in the same manner as the recording of operating expenditures; the total cost is expensed in the year of acquisition.

Therefore, decisions such as those to incur a capital outlay or to lease are often influenced by the immediate needs of deficit/surplus management and not necessarily on the basis of what is more economical for the government. In addition, expensing capital acquisitions in the year acquired results in a distortion of the annual costs of individual business lines.

For example, in our 1994 chapter titled Management and Operation of Crown-owned Office Buildings, we explained that the government makes no distinction between a \$25 million outlay to renovate a building that will provide benefits for perhaps 15 to 20 years and a yearly \$4 million outlay to lease equivalent space in a private building.

Full accrual accounting would spread the cost of acquiring physical assets over their useful life, rather than being expensed in the year paid. This would put purchase and lease options on a common basis (cost of resources used) and would permit operational managers to make improved decisions that make economical sense to the government.

18.30 While four important accountability documents referred to above — the Budget, the Public Accounts, Reports on Plans and Priorities and departmental Performance Reports — are all moving to a full accrual basis, the government has not announced any plans to ask Parliament to appropriate resources on this same basis. This leaves out the fifth important accountability document — the Main Estimates and the associated appropriations. In our view, the likelihood of encouraging departmental planning, managing and reporting to focus on resources consumed to achieve results will significantly increase if supply moves to a full accrual basis and ministers, deputy ministers and government managers are held to account on this new basis. As can be seen in Exhibit 18.6, appropriating funds on a full accrual basis is currently the missing link in the government's plans to move to full accrual accounting.

Exhibit 18.6 is not available, see the Report.

18.31 The benefits of a full accrual basis of accountability were stressed as far back as 1962. The Glassco Commission believed that moving in this direction would provide:

- greater cost consciousness leading to better use of resources;
- improved decision making leading to better allocation of resources; and
- better evaluation of performance leading to better accountability.

18.32 The benefits of an accrual-based appropriation (supply) process, for both management and Parliament, have gained international as well as domestic acceptance. Australia, the United Kingdom and New Zealand as well as the Province of Alberta have either moved to or plan to move in the near future to an accrual-based appropriation process.

18.33 Accrual-based supply would also benefit Parliament's oversight responsibilities by providing parliamentarians with consistently prepared information that facilitates linking plans and supply with results achieved. Aligning the supply process with the same basis of accounting the government will use for planning, managing and reporting would facilitate oversight by Parliament.

18.34 Treasury Board Secretariat officials have informed us that they are reviewing for Parliament's consideration various options for modifying the supply process. To help achieve the full benefits of FIS, we believe that the Secretariat, in conducting this review, needs to give serious consideration to focussing the supply process on the cost of consuming resources (full accrual basis) instead of on the cost of acquiring resources.

18.35 To help ensure that parliamentary control and authority are preserved in moving to full accrual appropriations, we believe the following basic principles are important to consider:

- clear purpose for each vote;
- dollar limits on the cost of resources that may be consumed;
- annual parliamentary scrutiny of appropriations;
- legislative support for full accrual appropriations;
- appropriation authority on the same full accrual basis as departmental planning, managing and reporting;
- government-wide treasury (cash) management oversight; and
- appropriations that distinguish between authorizing operational expenses (full accrual including depreciation) and authorizing capital investments (acquisition of capital assets).

Obtaining departmental “buy-in”

18.36 While FIS is primarily a central governmental initiative, departments are in a position to make a number of critical decisions pertaining to FIS. These decisions were identified in the 1998 Treasury Board Secretariat document, FIS Training Framework. We agree fully with the Secretariat’s view that only if full implementation of the FIS vision and mission is undertaken by departments will the FIS objectives be achieved.

18.37 Deputy minister “buy-in” to full implementation of FIS is crucial. In this respect, the Secretariat’s FIS Training Framework reported that meetings with departmental managers in 1997-98 “suggest that departmental commitment to FIS actions is not complete....” This concerns us greatly and will be reviewed in future audits.

18.38 Central agencies have an important role to play in ensuring deputy minister commitment to the vision and mission of FIS. Rewards, recognition and, if necessary, sanctions may be needed. The Privy Council Office is responsible for the strategic management of senior personnel in support of the federal government’s management agenda. As a result, it has a particularly important role to play in the success of any significant government initiative, particularly those that require the “buy-in” of deputy ministers.

18.39 We are pleased to observe that the Secretariat intends to require departments, by 2001, to prepare the financial information within their Reports on Plans and Priorities and their departmental Performance Reports on a full accrual basis. This will encourage departments to develop, and integrate into their day-to-day management, comprehensive costing systems capable of providing the costs of individual business lines and related components to enable managers to link this information to results achieved.

18.40 We support this intention. We believe that such a move, together with the move to accrual-based appropriations and the active support of the Privy Council Office, will encourage departments and particularly deputy ministers to integrate FIS into their day-to-day management activities.

18.41 Departments need to put in place the necessary infrastructure, including appropriate systems and human resources, to achieve the full vision of FIS.

Focus of the Audit

18.42 The objectives of the audit were to review and assess the government's overall management of FIS. The audit work was carried out at the Treasury Board Secretariat, Public Works and Government Services Canada and at a selection of departments implementing new financial systems. More details on the objectives, scope and approach of the audit can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

FIS Project Management

18.43 Role of the Treasury Board Secretariat. The Treasury Board Secretariat sees its role as providing leadership, direction and advice. The Secretariat carries out its role by monitoring and facilitating the implementation of FIS at both the centre and within departments. A well-coordinated effort is critical to ensure that the full vision of FIS is achieved.

18.44 We expected that the Secretariat would provide overall project management of FIS, including:

- developing an ongoing risk management process;
- providing appropriate guidance and assistance to departments;
- developing an appropriate accounting and systems framework;
- monitoring the implementation of FIS at both the centre and within departments;
- monitoring the overall costs of FIS implementation; and
- facilitating training and change management at the centre and within departments.

18.45 Risk management of FIS overall includes three components: the FIS project office, the central systems and departmental systems. The Treasury Board Secretariat, as part of the early development of FIS, carried out a high-level risk assessment that covered all of these components.

18.46 For the development and implementation of the central systems component, the Receiver General and the Secretariat embarked on a process of joint continuous risk management in January 1997. This resulted in a risk assessment, which was completed in April 1997 and focussed primarily on the Central Financial Management and Reporting System component of the central systems. In addition, this led to joint risk management workshops, which are held periodically to identify, monitor and mitigate risks. The latest workshop was held in June 1998 with an objective to "build on previous risk assessments and identify any additional risks associated with government-wide transition and implementation of FIS." This joint risk management process identified a number of central system transition risks to be mitigated by the Secretariat, such as the need for a Master FIS Implementation Plan for years 2000 and 2001, the need for risk assessments of departmental readiness and the cost of departmental systems. The transition is the three-year period, starting in 1999, during which departments will move to the new central systems, a process that will be key to the success of FIS.

18.47 To help departments with their move to the new FIS environment, the Treasury Board Secretariat has, to date, provided departments with a common chart of accounts, a departmental FIS–readiness checklist and a number of draft accounting policies. In addition, the Receiver General has provided guidance on input/output requirements. To allow them to finalize system requirements, departments are looking to the Secretariat and the Receiver General for final versions of these documents and policies as well as guidance on accounting policy areas not yet addressed.

18.48 FIS implementation plans and costs. The FIS implementation is scheduled to take place over three years starting in April 1999. We recognize that the Treasury Board Secretariat is aware that Year 2000 is a departmental priority at this time. However, we believe that the Secretariat needs to become fully aware of departmental FIS implementation plans and actions in order to facilitate and monitor overall progress. In this respect, we were pleased to note that the Secretariat accepts responsibility to monitor departmental implementation plans and to expand the related continuous risk assessment process. To this end, it has requested preliminary information from departments in a special section of their business plans filed in June 1998. We will review and assess the adequacy and use of this information in future audits. With few departments committing to the 1999 implementation date, and if few commit to implementing in 2000, then the last year of implementation (2001) will, by default, be extremely busy. This will place significant stress on FIS implementation at that time.

18.49 While better cost information for decision making is an expected benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of implementing FIS, which could be significant. We recognize that much of the work on FIS also supports other objectives such as upgrading aging financial systems and making systems Year 2000–compliant. However, we are concerned that no one is monitoring the overall cost of implementing FIS. The 1995 Treasury Board submission required that the Secretariat report back to the Treasury Board on the projected costs of FIS, including departmental implementation. This has not yet been done.

18.50 The Secretariat recognizes that change management is important and has developed a formal FIS Training Framework. Although the time frame is short, we found this framework to be well thought out and comprehensive, with a clear recognition of the significance and broad nature of the training required to ensure success of the broad vision of FIS. We will assess the progress of implementation of the training plan in future audits.

18.51 The Treasury Board Secretariat should implement its plans to expand its continuous risk assessment process and to monitor and facilitate the implementation of FIS government–wide to help ensure that the full benefits of FIS are achieved.

18.52 In future audits, we will continue to monitor actions currently under way and planned by the Secretariat to:

- ensure that its risk management process includes all aspects of FIS, from government–wide financial reporting to information for managing departmental business lines, and covers the entire FIS implementation period, as well as that all significant risks are identified, monitored and updated on an ongoing basis;
- determine the status and completeness of the FIS implementation plans of departments and monitor their progress;
- finalize appropriate accounting and other FIS–related policies and communicate these to departments; and
- determine and report to the Treasury Board and to Parliament the full costs of FIS implementation.

Adequacy of Control Frameworks

18.53 The FIS vision and mission describe how FIS will enhance the government’s decision making and accountability while supporting program review, business planning, budgeting, expenditure management and other management processes. We expected that the Treasury Board Secretariat would have developed guidance describing

how central agencies and departments could meet this broad vision of FIS and that departments would have prepared more detailed plans covering their individual implementation.

18.54 We found that the Secretariat had developed such guidance, referred to as the “FIS Control Framework”, to describe how the financial accounting and controls will work under the new FIS environment, including a high-level explanation of the links between the central and departmental systems. This overall framework provides a guide to the development of more detailed plans required for the design and implementation of the central systems and the individual departmental financial systems. However, the framework focusses on financial accounting and controls but does not provide guidance on how to establish stronger financial management capabilities, such as the integration of FIS into departmental management decision making as outlined in paragraphs 18.21 to 18.24.

18.55 The Receiver General has prepared a more detailed “Receiver General Control Framework” for the development and implementation of the central systems. However, the departments included in the scope of our audit had not yet prepared a detailed plan (control framework) for the post-implementation FIS environment or for the transition from the existing basis to the full accrual basis of accounting.

18.56 The FIS and Receiver General control frameworks reasonably describe the financial accounting and control environment after FIS is fully implemented, but only as it relates to external financial reporting in the Public Accounts of Canada. Key types of transactions, for example, physical assets and inventories, required in future years to introduce full accrual accounting within departments for day-to-day management of business lines and related components are not included.

18.57 Departments will move to the new FIS environment over a three-year period starting in 1999. During this transition period, some departments will be FIS-compliant and some will not — that is, some will produce financial information on the full accrual basis while others will still be using the existing accounting basis. All of this information will need to be brought together, at the centre, on one basis, to produce the summary financial statements of the Government of Canada. While the Receiver General is currently in the process of preparing an addendum to its control framework to cover this transition period, we found that the overall FIS control framework prepared by the Treasury Board Secretariat does not adequately describe the accounting and control environment that will be required during this transition period.

18.58 Treasury Board Secretariat’s FIS Master Implementation Plan lists tasks that, according to Secretariat officials, will deal with each of the matters described above. In future audits, we will monitor progress in carrying out this important work.

18.59 **The Treasury Board Secretariat and Receiver General should implement their plans to provide guidance, such as control frameworks, covering all types of transactions required for the full implementation of FIS.**

18.60 **The Treasury Board Secretariat should implement its plans to:**

- **describe the accounting and control environment for the transition period;**
- **provide guidance to departments on the integration of FIS into departmental decision making; and**
- **facilitate the development of departmental plans that cover both the post-implementation FIS environment and the transition period.**

18.61 **Departments should develop detailed plans that set out the accounting and control requirements for both the post-implementation FIS environment and the transition period.**

Systems Renewal: Development and Implementation of New Central Systems

18.62 As described in paragraph 18.19, the Receiver General is responsible for replacing the current Central Accounting System with a modernized suite of central systems that will accept summary-level financial data from departments. These systems include the development of a number of new systems, including the new Central Financial Management and Reporting System and the Receiver General – General Ledger, as well as upgrading existing Receiver General systems such as the Standard Payments System, the Pay System and the Bank Facilities System.

18.63 We expected that the Receiver General would develop central systems that met user requirements, were subject to appropriate project management procedures, and were consistent with the overall FIS control framework.

18.64 Overall, the development of the central systems was consistent with the FIS and Receiver General control frameworks. To determine the information requirements of central agencies and other users of government-wide information, the FIS Project Office carried out a fairly extensive consultation process with Treasury Board Secretariat, Finance, Receiver General and Statistics Canada officials. These requirements were included in the formal request for proposal for the design of the new central systems.

18.65 The Receiver General has extensive project planning and management processes for the development and implementation of the new central systems. We found that these processes, which focus on ongoing risk management, were generally working well.

18.66 For example, the risk management process has identified that some development is behind schedule but, according to Receiver General officials, the central systems implementation should take place as planned in April 1999. The risk mitigation plan for these schedule delays calls for the compression of the testing period and has moved the start date of the preproduction pilot several months closer to the planned implementation date. In addition, some of the central systems will not be ready to be tested until later in the preproduction pilot. This increases the risk of omission (items not tested) and leaves less time for corrective action, if problems are identified.

18.67 Once the central systems are implemented in April 1999, there will be a three-year transition period during which departments will move from the existing Central Accounting System to the new central systems. This transition will be particularly important for the Receiver General because, during that period, there will be two central systems in operation (the old and the new). In addition, during this transition period, there are conversion risks, at individual departments as well as at the Receiver General, as departments move to the new environment. Since the risk of errors increases in an environment of constant change, the need for ongoing risk management covering this transition period is critical. While the Receiver General's ongoing risk management process had been focussed on the risks associated with the current central system development, we note that transition-related risks were formally added to the Receiver General's risk issues summary during the latest joint Receiver General-Treasury Board Secretariat risk management workshop held in June 1998. In addition, the Receiver General has various contingency plans in place in the event that systems do not work as planned.

Systems Renewal: Development and Implementation of New Departmental Systems

18.68 As mentioned, we found that the FIS implementation effort within departments has generally focussed on implementing new financial systems that will eventually provide financial accounting information for external reporting under FIS. In addition, we found that Year 2000 compliance has been driving the current push to implement these new departmental financial systems. This means that departments still have major challenges ahead in achieving the broader FIS vision outlined in Exhibit 18.1. Once the Year 2000 situation is resolved, we believe

that there will be a need for some form of additional incentive to motivate departments to ensure that they implement the necessary components for achieving the full benefits of FIS and that they meet the April 2001 target date for implementation.

18.69 Some departments have already implemented their new systems while others are at various stages of planning, development or implementation. We reviewed the implementation of six departmental financial systems (see **About the Audit**), with a view to determining the lessons learned that could provide guidance to the departments that have yet to implement their new systems. Exhibit 18.7 provides examples of lessons learned identified by the financial system developers themselves.

Exhibit 18.7

Best Practices and Lessons Learned by Departments

The implementation of a modern financial system is far more complicated than anyone would predict. During our review, departments described to us the best practices and lessons learned that they believed would help other departments that are beginning to implement a new system.

Examples of Best Practices

Individual departments used many industry and government best practices, including several we have suggested over the years. These include the use of time reporting for departmental employees, performance measures, risk management, involvement of sponsors, and open communications. For example:

- Foreign Affairs and International Trade Canada put in place time reporting for departmental employees working on the implementation of the new system, and other performance measures.
- The Receiver General, with the active participation of sponsors, instituted a rigorous continuous risk management process. Project managers now know, when they have a problem, how serious it is and what priority it should have.
- Fisheries and Oceans has taken the position that it should move ahead slowly based on the assessment of other departments' success with their systems. This has led to a stable installation at the Department.

Examples of Lessons Learned

Initiation of the Project:

- It is important to make changes to business processes before automating them.
- Technical infrastructure and team facilities are needed at the start.
- The time needed for cleaning up information in existing systems is generally underestimated.
- Testing is more complex and needs more time than anyone planned.

Project Management:

- Project management best practices and rigorous discipline are key to delivery.
- Knowledge transfer from consultants to staff must be planned up front.

Project Execution:

- Project office staffing needs have been underestimated especially after initial implementation.
- Information technology experts need to be involved in the implementation.
- Once the plan is set out, stick to it - if major events occur, react quickly with a new plan.

- Be prepared to face high turnover by having backup plans.
- It is important to control changes to requirements rigorously.

18.70 We also identified a number of additional findings that specifically relate to implementation of the departmental financial systems and the significant challenges that affect all the departments. The following paragraphs summarize our findings on the risks the government faces in implementing the full vision of FIS.

18.71 Management reporting. Given that the use of financial information for management decision making is one of the key objectives of FIS, we expected to find that the new financial systems would have management reporting capabilities. However, we found that none of the systems we reviewed had adequate management reporting in place. We noted, though, that each department had plans to meet this requirement in the future.

18.72 Organizational change. Departments will undergo significant change if they meet the full vision of FIS. New financial systems, full accrual accounting, and responsibility for detailed financial information will all add a new dimension to the role of departments. The Treasury Board Secretariat has already recognized the importance of managing the significant changes required to achieve the full vision of FIS.

18.73 However, as previously noted, departments have not yet incorporated in their systems the capability to allow departmental line managers to meet the broader FIS vision for management decision making. We found a wide range of management plans for access to basic financial information, from access limited to financial managers to access provided to all managers. Since it is still early in the life of FIS, we would expect the departments to prepare plans for how they intend to meet FIS goals for better financial information for use by managers. We will monitor progress in this area as part of our future audits.

18.74 Costs. We found that departments need to do a better job of estimating and tracking resources used to implement new systems and other major projects as a matter of good project management. Since one of the objectives of FIS is better information for management decision making, it would set a good example to “walk the talk” with departmental implementation of FIS. As explained in paragraph 18.49, we recognize that much of the work on FIS also supports other departmental objectives. However, the identification and capture of FIS implementation costs is currently ad hoc and unorganized. We also found that when the financial systems were purchased, there was no calculation in departments of total life cycle costs, including the future costs for maintenance, enhancements and upgrades. We believe that these future costs are significant because they typically represent the largest part of the investment in major systems development.

18.75 Controls and security. We found that the plans for security and management control in the financial systems we reviewed were weak, for example, access and document authorization. We are concerned that without appropriate operational controls, there is the risk of lapses in sound financial management. These types of management and systems controls need to be considered before the design is declared complete. They are more difficult to implement after the system is operational. We are also concerned that without appropriate system access controls, particularly for developers, changes could be made that compromise the integrity of the system.

18.76 Resources. Implementing these financial systems is extremely resource-intensive. Some departments reported that their biggest concern is the difficulty of obtaining and retaining experienced, skilled resources. Since many departments are looking for the same resources at the same time, they tend to compete with each other and create a temporary scarcity. We expected to see this risk dealt with by the Treasury Board Secretariat and the cluster groups (described in the Appendix). In most instances, however, the government has chosen to rely on private sector consultants who, in trying to meet the demands for services, are themselves still learning about the systems. Some departmental managers found that they must pay close attention to consultants’ work to ensure that they are getting full value. This is all the more difficult because departmental staff are still becoming familiar with the system. In addition, one of the lessons learned by departments (see Exhibit 18.7) was ensuring that appropriate knowledge transfer occurs from consultants to departmental staff.

18.77 Internal audit. We expected that departmental internal audit groups, where they have the expertise, would play a key role in reviewing progress, reviewing risk assessments, conducting reviews of security and management controls, and establishing requirements for auditability and data integrity. This would help ensure the success of both the implementation of new departmental financial systems and the move to FIS.

18.78 In one department we found that internal audit played a key role where the auditors were involved with the project team from the beginning. However, we also found that, in most cases, auditors do not yet have the training and expertise to audit the complex requirements for authorizing and controlling actions that exist in the shared systems.

18.79 The Treasury Board Secretariat should provide additional guidance to departments on the development of their departmental FIS implementation plans. To ensure that these plans are complete, departments should ensure that they include the following provisions:

- **management reporting requirements under the FIS environment;**
- **a change management plan showing how management and staff will be reoriented, reorganized and retrained to meet all of the requirements of the new FIS environment, not just the systems renewal component;**
- **periodic determination and reporting of the full life-cycle cost of their FIS implementation;**
- **a plan for security and management controls that would be subject to an external review prior to putting the new systems into production;**
- **a plan to manage the risks associated with the current lack of experienced, expert resources for systems implementation and enhancement; and**
- **the role for, and the training of, departmental internal audit groups in reviewing progress, reviewing risk assessments, conducting reviews of security and management controls, and establishing requirements for auditability and data integrity.**

Conclusion

18.80 Exhibit 18.8 provides a scorecard of progress to date in implementation of FIS. However, to realize the full benefits of FIS, a number of challenges remain to be addressed.

Exhibit 18.8

Scorecard of Government Progress to Date Under FIS

	Planned Under FIS	Progress to Date Under FIS
Government-wide financial information		
• Financial statements that report all assets and liabilities	Yes	In Progress
• Monthly financial statements on the same basis as the annual statements	Yes	In Progress
• Annual financial statements available soon after the fiscal year end	Yes	Limited progress*
• Annual financial statements that are audited	Yes	In place

Departmental financial information		
Complete, accurate, relevant and timely financial information, for example:	Yes	*
• to set prices and fees or to recover costs;	Yes	*
• to assess stewardship of assets and liabilities;	Yes	*
• to assess efficiency and cost effectiveness of operations;	Yes	*
• for use in selling or restructuring operating units; and	Yes	*
• for lease versus buy decisions.	Yes	*

* Planned for later implementation

18.81 The most significant challenge will be to integrate FIS into day-to-day departmental decision making. The full benefits of FIS will be realized only through the provision of more complete information on the costs of business lines and related components to enable managers to link this information to results achieved when making key decisions.

18.82 Through changing the basis on which Parliament appropriates funds, the government and Parliament can help ensure that FIS is successfully implemented. But this, by itself, is not enough. Central agencies and departments must also act to help ensure that the government achieves the full vision of FIS. Central agencies can help lay the foundation for success by requiring departments to prepare their Reports on Plans and Priorities as well as their departmental Performance Reports on a full accrual basis, and by obtaining complete departmental “buy-in” to the full vision of FIS. Deputy ministers of departments must then ensure that all the necessary infrastructure is put in place within each of their departments, including appropriate systems and human resources, to fully achieve the objectives of FIS.

18.83 The FIS Control Framework reasonably establishes the financial accounting and controls required under FIS. However, no guidance has yet been provided on the required integration of FIS into departmental management decision making as envisioned under FIS. In addition, more guidance is required on the accounting and control environment that will be required during the planned three-year transition period during which departments will move from the old Central Accounting System to the new FIS environment.

18.84 The central systems have been developed in a manner that is consistent with the FIS and Receiver General control frameworks. The lessons learned from the implementation of new departmental financial systems need to be gathered and communicated to those departments that have yet to implement their new systems.

18.85 Given the large-scale financial systems renewal exercise under way, we believe there is a unique opportunity to put the full vision for FIS in place by the 2001 target implementation date. To achieve this vision, and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to assess the government’s progress toward achieving the full benefits of FIS.

Treasury Board Secretariat’s comments: The government agrees that FIS is a key vehicle to enable changes, such as the modernizing of comptrollership, that are important to both governance and management. The chapter describes the main challenges that face the government in implementing FIS and notes that either they are being addressed or plans are in place to address them.

We offer the following comments on the three strategic challenges that are highlighted:

- *Integration of FIS into departmental management: This will take place over a long period of time, as it*

requires not only an improvement in available information but also a change in culture. The implementation of the comprehensive FIS Training Framework will go a long way toward meeting this challenge.

- *Moving to accrual-based appropriations: The views of the Office of the Auditor General on this important subject are appreciated. But there are alternatives to be considered and stakeholders, including Parliament, to be consulted before the Treasury Board Secretariat makes a formal proposal to change the basis of appropriations.*

- *Obtaining departmental buy-in: The involvement of senior financial officers (SFOs) from across government in the four oversight committees that governed FIS from November 1995 to March 1998 helped considerably with this challenge.*

The committees that are being established to oversee the modernizing of comptrollership, including the Modernization Task Force of Deputy Ministers, and the new FIS SFO Steering Committee will continue to engage senior managers in departments and agencies.

About the Audit

Objectives and Criteria

The objectives of the audit were to review and assess the government's overall management of FIS, including:

- whether the FIS and Receiver General control frameworks provide an adequate framework for the new accounting environment by dealing with all significant risks;
- whether the central systems are designed, developed and implemented in a manner consistent with the FIS and Receiver General control frameworks; and
- whether the development and implementation of a selection of departmental financial systems are adequate and could provide lessons learned for those departments that will be implementing their new financial management systems in the future.

Detailed audit criteria were developed and agreed with government officials at the commencement of the audit and, where relevant, are reflected in the body of this chapter.

Scope

The audit work on the management of FIS overall, the central control frameworks and the development of new central systems was carried out at the Treasury Board Secretariat and at Public Works and Government Services Canada.

The departmental system implementations selected were at Public Works and Government Services Canada, Treasury Board Secretariat/Department of Finance, Correctional Service Canada, Fisheries and Oceans, Transport Canada and Foreign Affairs and International Trade Canada.

Approach

We interviewed key personnel at the Treasury Board Secretariat, Receiver General/Public Works and Government Services Canada and the selected departments. We also reviewed relevant documentation and examined demonstrations of both prototypes and developed software applications. In addition, we reviewed previously conducted internal audits and other independent reviews.

Audit Team

Assistant Auditors General: Ronald C. Thompson and Doug Timmins

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Appendix — The Historical Background Leading to FIS

The call for financial management reform is not new

For over 35 years, there has been a common call for improvements in financial management to support government decision making. The 1962 Royal Commission on Government Organization, the 1979 Royal Commission on Financial Management and Accountability, the Auditor General's 1987 Financial Management and Control Study and the government's 1997 Independent Panel on the Modernization of Comptrollership have all recommended the need for financial management reform. Exhibit 18.3 in the chapter describes some of the key recommendations of these reviews.

Treasury Board approved the FIS initiative in 1989

In July 1989, the Treasury Board formally approved the government's proposal to “develop and implement a new Financial Information Strategy (FIS) for the Government of Canada.” As described in the government's background document *A Financial Information Strategy for the 1990s and Beyond*, there was an “urgent need” by the central agencies, primarily the Department of Finance and the Treasury Board Secretariat, for more timely and accessible financial information to assist in the overall management of government.

The government also recognized that the present Central Accounting System, a then 20-year-old computer system, had reached the end of its economic life and needed to be replaced. The government believed that it had a unique window of opportunity to start building a modern information infrastructure that would meet the needs of that time, and last the government through the 1990s and beyond.

The government reviewed two options at that time: a centralized financial information approach (essentially a modernization of the existing Central Accounting System) and a distributed financial information approach (departments providing summary information to a central point). The latter option was chosen as the basis for the FIS proposal because it eliminated the duplication of detailed information at the centre. The focus of the FIS initiative was on the information required by the central agencies to manage government overall. Departments were seen as providers of the summary information required by the central agencies.

Minister of Finance gives FIS a much-needed push

For six years, little progress was made in implementing FIS, although some effort was made to revitalize the project in 1994. Then, in his February 1995 Budget, the Minister of Finance stated that the government would move to full accrual accounting. While no timetable for full implementation was given, the announcement placed renewed pressure on the government to ensure that the appropriate systems, people and infrastructure would be in place to support the move to full accrual accounting.

In November 1995, the Treasury Board endorsed FIS as a “government priority” and approved the updated FIS objectives, scope, and implementation approach. Under the renewed strategy, responsibility for accounting was to be fully decentralized to the departments, which would now be accountable for the

quality and timeliness of the financial information they provided to the centre for government-wide reporting purposes. Departments would need to upgrade their financial management systems so that they could maintain departmental general ledgers and, ultimately, produce auditable annual departmental financial statements.

To help departments upgrade their systems in a cost-effective manner, the government initiated the Shared Systems Initiative for financial management systems. Departments were to select one of seven approved financial systems and, through the use of "cluster groups", would share the costs of development of core system requirements, training and related maintenance.

In addition, the scope of FIS was broadened from its initial focus on the government-wide information needs of central agencies. FIS was now seen as providing the basis for improvements in management accounting and accountability in departments and agencies, as well as improvements in government-wide financial reporting. The government's current vision, mission and tactics for the implementation of FIS are described in Exhibit 18.1 of the chapter.

The new central systems were planned to be completed by April 1998. This deadline has since changed to April 1999. Once departments become FIS-ready, they will then move to the new FIS environment in one of three annual "waves" starting in April 1999. Full implementation is now scheduled for April 2001. The five-year implementation costs for the Receiver General and Treasury Board Secretariat, covering the 1995-2000 period of the original plan, were initially estimated to be \$23 million. This estimate did not include the cost of departmental implementation of FIS.

Foreword

Report of the Auditor General to the House of Commons for December 1998

Foreword

I am pleased to present the third volume of my 1998 Report. This Foreword is followed by “Matters of Special Importance - 1998” and the Main Points from all of this year’s chapters. In addition, this volume contains 11 chapters, bound separately:

19. Electronic Commerce: Conducting Government Business via the Internet
20. Preparedness for Year 2000: Government–Wide Mission–Critical Systems
21. Canadian International Development Agency - Geographic Programs
22. The Federal Science and Technology Strategy: A Review of Progress
23. Veterans Affairs Canada - Disability Pensions
24. Revenue Canada - International Tax Directorate: Human Resource Management
25. Transport Canada - Investments in Highways
26. Contracting for Professional Services: Selected Sole–Source Contracts
27. Grants and Contributions: Selected Programs in Industry Canada and Department of Canadian Heritage
28. Follow–up of Recommendations in Previous Reports
29. Other Audit Observations

My Office issued the first volume of the 1998 Report in April, containing nine chapters, and the second volume with nine chapters in September.

In addition, this year my 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
- auditor's reports and observations on some 90 Crown corporations and other entities, territorial governments and organizations, and international organizations.

In 1997-98 my Office completed special examinations of the Farm Credit Corporation, National Capital Commission, Great Lakes Pilotage Authority, Cape Breton Development Corporation and Atlantic Pilotage Authority. Further, in the subsequent period April to October 1998, my Office also completed special examinations of Atomic Energy of Canada Limited, Defence Construction (1951) Limited, National Arts Centre Corporation and Via Rail Canada Inc.

Under section 11 of the *Auditor General Act*, I may from time to time undertake assignments at the request of the Governor in Council. In June I reported to the Minister of National Revenue and the Minister of Finance on one such examination of the requirement to report specified foreign property under section 233.3 of the *Income Tax Act*.

Main Points

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Expenditure and Work Force Reductions in the Public Service

Chapter 1 - Main Points

1.1 Expenditure and work force reductions have affected the public service and public servants for more than a decade. In 1995, the government launched Program Review, an initiative aimed at rethinking and realigning government programs in light of fiscal restraints.

1.2 To better manage expenditure and work force reductions, central agencies moved from imposing, directing and prescribing to providing leadership, guidance and support to departments. For example, instead of adopting the “one size fits all” approach, Treasury Board Secretariat proposed a management and accountability framework to departments and allowed incentive programs to take into account the differences in their context and operational environment.

1.3 Program Review was a success from many perspectives. The deficit has been reduced and personnel costs have decreased for the first time in more than a decade. In spite of a difficult climate, reductions were implemented without major work disruptions; and financial departure incentives have been effective in minimizing layoffs.

1.4 The cost of achieving work force reductions was high, however, not only in dollar terms but in human terms as well. For example, between 1992 and 1997 the government paid incentives to some 46,000 public servants, military and RCMP members to leave or retire. Furthermore, work force reductions have amplified a number of human resource issues, such as the need for rejuvenation and renewal and the need to modernize and simplify human resource systems. Many studies and our own audit work indicate that the public service is an institution under significant stress and that strong actions are now required.

1.5 Significant improvements were made in the management framework put in place by central agencies. Nonetheless, more efforts are needed to improve the management of work force reductions — for example, in critical occupational groups where there might be surpluses in some departments but shortages in others.

1.6 There is a need to improve accountability to Parliament for expenditure and work force reductions, and for the related costs. Roles, responsibilities and accountabilities of central agencies and departments in the management of work force reductions also need to be clarified.

Expenditure and Work Force Reductions in Selected Departments

Chapter 2 - Main Points

2.1 As a result of a lengthy period of fiscal restraint and recent expenditure reduction programs, some federal government agencies have been abolished, some departments merged and others reduced in size. It is estimated that the public sector work force will have been reduced by approximately 45,000 employees between April 1995 and March 1998.

2.2 We selected seven departments to examine how and the extent to which expenditure reductions have been implemented. These organizations, representing over 170,000 employees, differed in size, structure and reduction targets.

2.3 Generally, departments we reviewed met their 1995-96 and 1996-97 expenditure and work force reduction requirements. Given progress to date, we expect that most of them will meet their reduction targets for the remaining two years of Program Review.

2.4 We found that ministerial commitment and departmental leadership were evident in setting direction and attaining momentum. Factors such as the size of the reduction, readiness for change and the time available to plan had an effect on departments' strategic planning for reduction. Departmental implementation of reduction was generally rigorous and employees were well informed both prior to and during the reduction process.

2.5 Although most reduction targets were met, and overall compliance with work force reduction policies had improved since our 1992 Report chapter, Payments to Employees under the Work Force Adjustment Policy, we found questionable actions in some departments. The need for incentive packages was not always well researched and there was a tendency to call for volunteers prior to identifying positions surplus to requirement. Best practices suggest that an organization should conduct a thorough cost/benefit analysis of alternatives; target incentives to areas where they are needed most; and identify the extent to which there is a need to call for volunteers.

2.6 Departments focussed primarily on meeting reduction targets in a timely manner. Less emphasis was placed on cost management. Such factors as the initial lack of necessary financial and human resource information, departments not having to fund entirely the departure incentives they provided, and an unclear Treasury Board Secretariat accountability structure for departmental work force reduction costs contributed to a general lack of cost consciousness in departments.

2.7 Throughout work force reduction, departments treated departing employees in a humane and sensitive manner. Departments paid less attention generally to those who remained and to their concerns regarding the loss of experienced and qualified colleagues, the level of workload per employee and future departmental direction. Departments have now entered a period of transition that will require not only adjusting organizational structures and operations but also paying particular attention to ensuring that work force capability meets future operational demands.

National Defence

Equipping and Modernizing the Canadian Forces

Chapter 3 - Main Points

- 3.1** A modern, multi-purpose, combat-capable force able to “fight alongside the best, against the best” is necessary to fulfil Canada’s defence policy commitments, although the policy does not require the Canadian Forces to possess every component of military capability.
- 3.2** According to Department of National Defence officials, Canada’s White Paper commitments are defined by the defence capabilities of the Canadian Forces. We found many equipment deficiencies that limit capabilities.
- 3.3** If the status quo persists, the Department’s available capital funding may not be sufficient to equip and modernize the force that National Defence is currently planning. Officials told us that they expect to be able to increase the capital portion of the budget. Nevertheless, they anticipate that hard choices may have to be made.
- 3.4** Personnel, operations and maintenance costs are rising, which is further reducing the portion of the budget available for capital equipment.
- 3.5** We found that the Department does not have an adequate policy framework to direct the almost \$1.4 billion it spends each year on equipment modernization. It does not yet have in place fully developed operational scenarios to guide planners, or performance information that identifies gaps.
- 3.6** Some other countries — notably the United States and New Zealand — have taken the lead in the way their government budgeting and management systems actively manage defence policy and resources.

National Defence

Buying Major Capital Equipment

Chapter 4 - Main Points

4.1 National Defence plans to spend almost \$6.5 billion over the next five years to purchase equipment that Canada's armed forces need to carry out their assigned tasks. As Chapter 3 indicates, the Department's available capital funding may not be sufficient to equip and modernize the force that is currently planned.

4.2 This chapter reports our findings on the management of six major capital projects with a total value of \$3.3 billion.

4.3 All six projects we examined are likely to meet their contract cost and performance objectives. For example, the Eryx anti-tank missile system and the Coyote reconnaissance vehicle appear to perform especially well and have attracted the interest of foreign armed services. Nevertheless, we are concerned about several of the management practices we observed.

4.4 We found that defence policy allows wide latitude in the level of equipment capability required. We noted in the projects we examined that affordability constraints resulted in only low-end capability being purchased, limitations in the number purchased, or both:

- the Maritime Coastal Defence Vessel is acquiring two sets of mechanical minesweeping gear for 12 ships effective only against some types of mines, and has not acquired some of the equipment necessary to patrol effectively in darkness and poor visibility;
- the Leopard C1 tank is being fitted with only an improved sight, although the army had considered a complete upgrade, including the gun and armour, to be the "minimum viable" option;
- the Griffon helicopter cannot meet the army's original lift and communications requirements;
- fewer Eryx missiles and Coyote vehicles have been purchased than were originally intended.

4.5 We are concerned at the extent to which the Department relies on professional judgment in making complex purchase decisions. Management did not conduct adequate analyses to justify its spending decisions for most of the projects we examined. Tactical studies often did not reflect the way officials said they actually planned to employ equipment, were done too late to influence decisions, produced results that contradicted the purchase decision, were undertaken by contractors who had an interest in the Department's decision, or were not done at all.

4.6 In three cases, the Department considered only a single option. In other cases, the options analyses were inadequate.

4.7 Only one project of the six fully met our expectations for a rigorous risk management process. No project we examined has suffered major problems so far because of this, but we identified several instances where better risk management might have improved project delivery.

4.8 Although test and evaluation processes were satisfactory in most cases, for some of the projects that involved commercially based designs, the equipment was not tested under actual operating conditions until after it had been introduced into service. Problems have since been discovered that have affected the operational capability of some of the equipment. The Department is currently working to resolve these problems.

4.9 The Department began a major management renewal program in 1994 that included the capital acquisition process. Because it considered other areas to be more important, it deferred work on capital equipment acquisition and it does not yet have an implementation plan. The Department has begun work on the plan, including three pilot projects. Because equipment acquisition is a government-wide process, the Department is working with Public Works and Government Services Canada, Industry Canada, and the private sector to improve government practices. We believe the departments concerned must develop a plan with definite dates and milestones to complete their reform process.

Revenue Canada, Department of Finance and Department of Justice

Interdepartmental Administration of the Income Tax System

Chapter 5 - Main Points

5.1 Three departments play a key role in administering the income tax system. The Department of Finance is responsible for the formulation of tax policy and the introduction of new tax legislation, Revenue Canada oversees the administration of tax laws and the Department of Justice provides legal advisory services and litigation services to both Finance and Revenue Canada.

5.2 Efficient and effective relationships among Revenue Canada, the Department of Justice and the Department of Finance are essential for the smooth functioning of the income tax system. This audit was undertaken because our past work had raised some concerns about the management of risk to the tax base. Our current examination found that the departments have taken many important measures to improve their relationships. We have been told that the proposed change of Revenue Canada to a new Canada Customs and Revenue Agency will not affect their relationships.

5.3 An important aspect of managing the risk to the tax base is the identification and correction of legislative deficiencies. We found that Revenue Canada and the Department of Justice regularly bring deficiencies to the attention of the Department of Finance. However, the correction of legislative deficiencies is left to the discretion of the Department of Finance.

5.4 As all three departments are key players in managing the risks arising from legislative deficiencies, it is important that they all be involved in deciding which deficiency should be given priority.

5.5 The management of tax litigation risks has been improved. However, Revenue Canada and the Department of Justice need to strengthen the partnership arrangement for planning litigation needs and managing the risks.

5.6 Settlements of income tax disputes resolved through consent judgments have been made on a mix of law and facts. Revenue Canada should provide transparency in the settlement agreements it undertakes. As an example, United States income tax law provides public access to settlement agreements, with privacy protection of the taxpayer's identity.

Population Aging and Information for Parliament: Understanding the Choices

Chapter 6 - Main Points

6.1 Canada today is sitting on a very favourable demographic structure, with a historically low ratio of youth and elderly to the working-age population. In the coming few decades, this situation will be radically transformed. By the second decade of the next century, when the leading edge of the baby boom generation reaches normal retirement age, the growth in Canada's elderly population will accelerate while that of the working-age population will slow to a crawl.

6.2 This demographic shift has the potential to affect government finances in a significant way. An aging population puts pressure on government spending through higher pension payments and increased demands for health care services. Also, unless there are significant changes in the patterns of work, this demographic change will reduce labour force growth dramatically, which in turn would slow down economic growth and, with that, the growth in government revenues. This combination could put enormous pressures on our public finances when the full impact of this demographic change is felt by the second decade of the next century, particularly if Canada's debt burden and tax levels remain high.

6.3 The government is well aware of these pressures; during consultations on reforming specific programs like the Canada Pension Plan, it provided detailed projections of the effects of demographic forces on CPP finances. This longer-term information not only helped inform public debate, but also motivated acceptance of the need for change. To a lesser extent, as government began discussing reforms to Old Age Security and the Guaranteed Income Supplement (the Seniors Benefit), it again provided longer-term projections of the financial impacts.

6.4 Yet what it has done to highlight the impact of demographics on the financial health of individual programs, it has failed to do for the financial health of the government as a whole. Consequently, parliamentarians are left to make annual financial decisions, many of which have lasting consequences, without a macro perspective — a summing up of the financial impacts that demographics can potentially have on the government's long-term financial health.

6.5 The importance of appropriate information to help parliamentarians understand the government's financial condition is clearly a responsibility and a theme on which we have reported over the last six years. This chapter, illustrating the feasibility of preparing such longer-term information and the significance of that information, is a continuum of the "Information for Parliament" chapters in our 1993 and 1995 Reports. The particular contribution of this chapter is its focus on the role of demographics in assessing the government's financial condition.

Federal Laboratories for Human and Animal Health Building Project

Chapter 7 - Main Points

7.1 The new Federal Laboratories for Human and Animal Health in Winnipeg contain some of the most advanced diagnostic, research and training facilities of their kind in the world. The facility is the first in the world to combine laboratories concerned with both human and animal diseases, and the first in Canada capable of handling the most dangerous viruses known. The facility is to be used by Health Canada and the Canadian Food Inspection Agency.

7.2 International experts involved in reviewing the design and construction of the facility have noted that it is extremely secure with regard to containment of biohazardous materials.

7.3 Despite a lengthy history of project proposals by Agriculture and Agri-Food Canada and Health Canada to construct new laboratory facilities, the Winnipeg project was undertaken without adequate analyses of existing laboratory capacity. The Winnipeg facility currently has space that exceeds its planned program needs and the amount approved by Treasury Board, and that has added to a national inventory of surplus laboratory capacity.

7.4 Health Canada and the Canadian Food Inspection Agency have informed us that they recognize the importance of ensuring that the facility is fully used, including the need to explore potential cost-recovery opportunities. To date, however, a comprehensive business plan and strategy for achieving these aims has not been developed.

7.5 In our opinion, the project is approximately 12 months behind schedule and could have been delivered for at least \$5 million to \$10 million less. In addition, the approved project budget of \$141.8 million does not accurately reflect the project's total cost to the taxpayer, currently estimated at \$176 million. The proposed project budget did not identify all project costs, as required by Treasury Board policy.

7.6 We identified several areas where Public Works and Government Services Canada can improve its practices in selecting and managing consultants on future complex projects like this one. We also noted that shared authority and accountability require careful management to mitigate risks of project delays and added costs.

7.7 As we have noted in reviewing other government projects, the current "build [up] to budget" approach, the lack of systemic incentives for seeking cost savings within approved budgets, and the absence of a departmental culture that supports such aims do not encourage the parties to identify and realize potential cost savings.

7.8 The new facility is a potential source of pride for all Canadians as it contributes to the global effort to identify and combat human and animal infectious diseases. Due to the nature of its programs, the Winnipeg laboratories will be expensive to operate and maintain. The challenge for Health Canada and the Canadian Food Inspection Agency will be to ensure that the full potential of this new facility is achieved.

Department of Finance

Effectiveness Measurement and Reporting

Chapter 8 - Main Points

8.1 In addition to functions that include preparing the Budget and providing economic policy advice to the government, the Department of Finance has responsibilities related to a number of policies and programs. The Department's 1997-98 planned expenditures of \$66 billion account for 43 percent of planned federal expenditures. The Department is also responsible for federal tax policy, including preferential tax provisions that are intended to lead to the achievement of a variety of government policy objectives.

8.2 The significance of the Department's policy and program responsibilities underlines the importance of its obligation to make known to Parliament and to the public, in a clear and meaningful manner, the nature and extent of those responsibilities, the objectives involved and the results achieved relative to those objectives.

8.3 Improvement is required in providing Parliament with clear and consistent statements of objectives and of the Department's policy and program-related responsibilities. For many policies and programs, the Department shares responsibilities with other departments and agencies. We found a general lack of clarity in documents directed to Parliament about the other departments and agencies involved and the manner in which responsibilities are shared.

8.4 We found gaps in reporting to Parliament on results achieved relative to objectives. Our findings in this audit are consistent with the findings of a number of audits of individual policies and programs undertaken by this Office over the past six years. The picture that emerges is one of known shortcomings, and insufficient attention to measuring effectiveness and reporting results to Parliament and the public.

8.5 Legislative provisions governing a number of the Department's policies and programs have been the subject of review by Parliament to consider whether the provisions should be changed to improve performance and to enable policies and programs to be adapted to new circumstances. Such legislative reviews are valuable in their own right; they are not, however, a substitute for systematic measurement and reporting of effectiveness information by the Department. We believe legislative reviews would be enhanced by Parliament having more regular and timely access to information on the results that policies and programs have achieved.

8.6 Planning for effectiveness measurement and reporting is not sufficiently linked with the Department's corporate planning process. The Department's current approach results in an effectiveness measurement function that is partial in coverage and not clearly integrated with the overall corporate management structure. In view of the limited resources allocated specifically to the function, we are concerned about the Department's capacity to meet its obligations to account to Parliament for results achieved.

Reporting Government Financial Results: The Importance of Complying with Objective Accounting Standards

Chapter 9 - Main Points

9.1 The 1980s and early nineties have seen major advances in financial reporting by sovereign governments, with Canada among the leaders. However, over the past two years the Government of Canada has begun departing from both objective accounting standards and its own stated accounting policies for certain transactions. Moreover, the 24 February 1998 Budget indicates that a similar departure will occur in 1998.

9.2 In 1996, transitional assistance for harmonizing PST with GST was included in the deficit even though provinces had not yet agreed to the harmonization by the end of the year. In 1997, funding of the Canada Foundation for Innovation was included in the deficit even though the Foundation did not exist by the end of the year. In 1998, the 24 February 1998 Budget indicates that funding of the Canada Millennium Scholarship Foundation will be included in financial results whether or not the Foundation exists by the end of the year.

9.3 As auditors of the government's financial statements, we are deeply concerned over this recent disregard by the government for objective accounting standards in reporting its financial results to Parliament and to Canadians. This is not merely a technical disagreement between an accountant and an auditor. Objective accounting standards are accepted and identifiable standards that are established by an arm's-length standard-setting body - the Canadian Institute of Chartered Accountants (CICA). Business firms cannot depart from objective accounting standards established by the CICA, to hide losses or to hide profits. Parliamentarians should expect no less from the government.

9.4 Meeting the significant challenges of the next decade will require, among other things, credible annual reports by the government on its overall financial health. In our view, departures from CICA standards and the government's own accounting policies must cease if credibility is to be restored to the reports that parliamentarians and others need.

9.5 Accordingly, we have recommended that the Government of Canada ensure that its accounting policies and practices conform with recommendations issued by the CICA's Public Sector Accounting and Auditing Board. Implementation of this recommendation will require continued diligence by the Public Accounts Committee of the House of Commons in reviewing the government's annual financial statements.

9.6 Although this chapter calls Parliament's attention to inappropriate accounting, there are related concerns that we have and will continue to report separately. They deal with accountability and parliamentary oversight for entities such as the Innovation Foundation and the Millennium Scholarship Foundation, and with whether or not such entities are, in substance, operating at arm's length from the government.

Canadian Human Rights Commission

Human Rights Tribunal Panel

Chapter 10 - Main Points

10.1 In 1977 Parliament established the Canadian Human Rights Commission and the Human Rights Tribunal Panel to resolve human rights complaints quickly, impartially and expertly. The Commission investigates complaints and, if it decides that an inquiry is warranted, forwards the complaint to the Tribunal for adjudication. This model was chosen as the alternative to the formal processes of the courts. However, the approach that has evolved is cumbersome, time-consuming and expensive.

10.2 Between 1988 and 1997, the Commission received about 7,450 signed complaints, excluding pay equity complaints. It made final decisions on about 6,550 of the 7,450 signed complaints. The Commission dismissed or did not proceed with about two thirds of these complaints. About six percent of complaints were forwarded to the Tribunal for inquiry.

10.3 Although major efforts have been made to improve the handling of complaints, it still takes a long time for a complaint to be reviewed — an average of about two years for the Commission and about a year for the Tribunal. In 1997 almost one half of the Commission's 900 open cases were still being investigated one year after the signing of the complaint.

10.4 The Commission tries to settle complaints through conciliation and the Tribunal also tries to mediate complaints after the Commission forwards them for inquiry. Because the Commission has its own settlement objectives, it is not a neutral conciliator. Since 1996 about 18 percent of complaints have been settled through early resolution or conciliation. The Commission took an average of about 45 months to reach a final decision when complaints were investigated and then sent to conciliation.

10.5 The Commission and the Tribunal are operating in a complex environment that poses major risks. The grounds for making a complaint are increasing and concepts of discrimination are becoming more complex. The environment also is more litigious and contentious. The Commission's total funding has been reduced from a high of \$16.15 million in 1992-93 to \$14.8 million in 1998-99. The number of investigators also has been reduced from a high of 37 to 25. Further, the Commission is experiencing a high turnover of investigative staff, necessitating the reassignment of cases to other investigators. We also are concerned that the Commission is not consistently adhering to some of its key investigative standards.

10.6 We note that the Minister of Justice has stated that a broad review of the *Canadian Human Rights Act* will be undertaken. The Commission has welcomed this proposal. The December 1997 Third Report of the Senate Standing Committee on Legal and Constitutional Affairs also called for a comprehensive assessment.

10.7 We agree that a fundamental review by Parliament is needed and recommend that the government identify and present to Parliament an integrated set of specific measures to increase the effectiveness of addressing human rights complaints. Possible measures are summarized in the concluding section of this chapter.

Agriculture and Agri-Food Canada

Cash Advance Program

Chapter 11 - Main Points

11.1 The Department's cash advance program is one vehicle the government makes available to producers of storable crops to provide additional flexibility in making marketing decisions. It consists of a short-term loan made available at harvest, a time when financial obligations of producers are often at their peak. The financing provides a bridge for producers until they market their crop and begin to earn revenue. In recent years, the annual amount of these loans has ranged from \$730 million to over \$1.2 billion.

11.2 The program has been very well received. Producers we contacted liked the availability and predictability of cash flow at harvest time, and the interest-free feature of the program. Many of the large agricultural assistance programs of the past have ended, and producers see this program as an important sign of continuing government support for the sector.

11.3 In 1993, the Department's Review Branch completed an evaluation that reached some positive conclusions about the program, but also raised some significant concerns, particularly with the program's interest-free nature. It also concluded that there was no firm evidence that the program contributes to orderly marketing.

11.4 In 1997 new legislation, the *Agricultural Marketing Programs Act (AMPA)*, was passed that updated and consolidated the two previous cash advance programs into one, and made permanent in legislation the interest-free provision. The rationale for providing advances interest-free was not made clear by the government, despite the evaluation's finding that a clear objective for this component was needed.

11.5 Under the new legislation, a review of the provisions and operations of the Act must be completed in the fifth year of operation, which begins in 2001. The 1993 evaluation furnished important information about the program's effectiveness; however, as in any study, some questions remain unanswered that we believe should be addressed in the coming review. Among others, these include whether producers indeed face a significant problem of access to credit at harvest time and whether losses arising from the government's guarantee on these loans are being well managed.

11.6 We identified limitations in how the cash advance evaluation findings were publicly reported. Similar limitations were noted in the dissemination of other studies produced by departmental branches on the impacts and effectiveness of programs. In our view, a number of characteristics of the Department, its legislation and stakeholder community create a strong case for more actively alerting outside parties to the existence and findings of effectiveness studies. Some areas of the Department are indeed taking steps in this direction.

Creation of the Canadian Food Inspection Agency

Chapter 12 - Main Points

12.1 The federal government is considering the use of alternative service delivery (ASD) arrangements in order to improve service delivery. The Canadian Food Inspection Agency (CFIA) was the government's first legislated service agency; it was created as a departmental corporation and became operational 1 April 1997. Its primary responsibility is to contribute to food safety, plant and animal health as well as to facilitate trade in all areas by providing inspection and related services.

12.2 There was a clear rationale for creating the Agency, including a 30-year history of studies related to reorganizing the federal food inspection system and the government's commitment to a new and better way of delivering services. Senior officials of the three federal departments then involved in food safety inspection supported the initiative to create a single food inspection service. This initiative illustrated that change can be best introduced and sustained when there is a clear rationale that has the support of senior officials.

12.3 The designation of a structured and independent team was crucial to managing the move to agency status. The team's work was separate from the ongoing business of inspections and quarantine activities, so those services could continue without interruption throughout the creation of the CFIA.

12.4 One of the driving forces behind the move to ASD arrangements is their greater flexibility in human resource management. With the move outside the *Public Service Employment Act* and the change to separate employer status, the shift to a new human resources regime was one of the Agency's greatest challenges. The complexities entailed in creating a new human resource framework as a separate employer need to be recognized and planned for early in the change process.

12.5 In an area of shared responsibility such as food safety, roles need to be carefully defined and mechanisms established to resolve unanticipated problems. The establishment of an accountability framework was a key concern during the creation of the CFIA. Specific responsibilities for food safety were assigned to the Minister of Agriculture and the Minister of Health. Some operational details were still being worked out as new issues arose during the first year of operations.

National Energy Board

Chapter 13 - Main Points

13.1 The *National Energy Board Act* has not been amended significantly since it established the National Energy Board (NEB) in 1959. While the NEB has been given some new responsibilities in areas such as frontier activities, its role has not changed much since its creation. However, its modus operandi has changed significantly. Through regulatory changes, the Board has moved from an interventionist approach to reliance on market-based forces, industry self-regulation and negotiated toll structures. During this period of evolution, the NEB has moved its operations from Ottawa to Calgary, downsized its staff complement by 35 percent and reorganized itself internally for greater efficiency. However, it has not objectively measured the extent to which it is being effective and relevant.

13.2 The Board has recognized that the aging of the Canadian pipeline system poses potential threats to public safety and the environment. The number of reported pipeline incidents has increased in recent years. A risk assessment methodology is being developed that should improve the targeting of inspections and safety audits. However, deficiencies in information management will need to be addressed.

13.3 The Board's ability to fully meet its environmental regulatory responsibilities is at risk due to shortfalls in its environmental inspection program — namely, in setting priorities and scheduling inspections and in inspection practices, which are too informal and unstructured.

13.4 Since 1991, the NEB has recovered most of its costs from industry. No change has yet been made to its cost allocation method, despite some concerns expressed by stakeholders about its fairness. The NEB has settled for simplicity at the expense of cost causality. The Board does not have a cost accounting system; it needs to recover costs in a way that is more equitable and acceptable to stakeholders.

13.5 The NEB is moving toward management for results, by adopting a new accountability framework and changing its style of decision making. While it is too early to evaluate the results of this initiative, we noted that significant opportunities exist to better link its human resource management activities to its vision of the future. In addition, the NEB will need to state and report clearly what it wants to achieve, monitor its performance on a regular and systematic basis and better link the results achieved to the costs.

Indian and Northern Affairs Canada

Comprehensive Land Claims

Chapter 14 - Main Points

14.1 Comprehensive land claim settlements are modern treaties that are significant not only to Aboriginal communities but also to all Canadians. Settlements involve the payment by the federal government to Aboriginal groups of almost two billion dollars and the clarification of various rights, including full ownership of over a half-million square kilometres of land. The first modern negotiated settlement of a comprehensive land claim was signed in 1975, and the most recent settlement was reached in July 1997. As of July 1997, 12 claims had been settled. Actual and potential claims involving over 200 First Nations are still to be settled.

14.2 The Government of Canada has chosen to settle these claims by negotiation rather than litigation or other means. Indian and Northern Affairs Canada is the lead federal representative in negotiations, with participation of other federal departments as appropriate. Other parties include the territorial governments, provincial governments, and the claimants. Although the Department bears significant accountability for results, it is not the only party that should be accountable; the good will and political resolve of all participants are needed in order to achieve appropriate settlements.

14.3 The government has reported that negotiated settlements establish certainty to land title and access to land and resources. However, removing uncertainty involves much more than signing an agreement. Among other things, successful implementation of settlements is critical to achieving the intent of these treaties. Implementation involves hundreds of projects with joint or separate participation of the parties. We found deficiencies in implementation, including inadequate or non-existent implementation plans, and the need to improve monitoring, reporting and evaluating.

14.4 Indian and Northern Affairs Canada has not demonstrated that it has always exercised adequate rigour in determining the nature and amount of assets that may ultimately be included in final settlements, including such considerations as the amounts of cash, land and other resources.

14.5 Settlements can take over 20 years to reach. Delays have had many causes. In our view, these long time frames do not contribute to cost effectiveness, and may result in less desirable outcomes for all concerned.

Promoting Integrity in Revenue Canada

Chapter 15 - Main Points

15.1 The success of Revenue Canada's programs depends largely upon voluntary compliance with tax requirements by individuals and businesses. We believe that one of the many factors affecting the likelihood of their voluntary compliance is their perception of the conduct of Revenue Canada's staff. An organization like Revenue Canada, with its decentralized operations and the extensive exercise of judgment by employees, must take adequate precautions to minimize the risk of employee misconduct. Our audit looked at various means that the Department employs to promote integrity among its employees.

15.2 All of these means, taken together, form an important foundation for the promotion of integrity in Revenue Canada. The Department investigates incidents of misconduct; discipline is imposed on employees found guilty of misconduct; and, on the whole, management takes appropriate action, where weaknesses are highlighted by incidents, to prevent similar misconduct. Further, distributing statements of its mission, vision and values and three key booklets on conduct are important steps Revenue Canada has taken toward promoting an ethical culture. Most employees have received some formal training on expected conduct.

15.3 There are areas where improvement will help Revenue Canada reinforce this sound foundation. Because the disciplinary process can be slow, its effectiveness as a deterrent to similar misconduct may be diminished. While management takes action to correct weaknesses highlighted by incidents, at times its responses are slow and focussed narrowly on local rather than department-wide weaknesses. Further, information provided on values and conduct is not presented in a way that allows easy understanding, and training is uneven. The Department takes few steps to monitor the level of employees' understanding of expected values and conduct. Nor does it provide an individual whom employees can consult on a confidential basis on issues of integrity.

Management of the Social Insurance Number

Chapter 16 - Main Points

16.1 The Social Insurance Number (SIN) was implemented in 1964, to provide Unemployment Insurance, Canada Pension Plan and Quebec Pension Plan clients with a file number. In 1967, it also became a file identifier for Revenue Canada. From the outset, the SIN was the subject of intense parliamentary interest and debate. The controversy focussed largely on the implications of a potential expansion of its use to become a universal identifier. The history of the SIN has mainly reflected the tension between balancing the often competing objectives of maintaining individual privacy and improving administrative efficiency and effectiveness.

16.2 Human Resources Development Canada has been administering the SIN in accordance with the intent of its legal framework whereby the SIN is intended to be a file identifier (account number) for certain federal government programs. However, the public often perceives the SIN to be a personal identifier or even an identity card.

16.3 The use of the SIN outside the federal domain has evolved beyond the intent of the Treasury Board policy established in 1989, aimed at preventing it from becoming a national personal identifier. Our audit found that the SIN has become the common numerical identifier both inside and outside the federal government for a wide range of income-related transactions and benefits, among other uses.

16.4 Changes to the *Income Tax Act* and Regulations have increased the use of the SIN at the provincial/territorial level and in the private sector, as have the growing number of data exchanges, comparisons and matches among various tiers of social programs.

16.5 However, the SIN has a number of weaknesses. Some of them are well known. As the use of the SIN has become more widespread, these weaknesses have grown in importance. They include the following:

- The information on SIN holders, particularly on births and deaths, is not always complete and accurate.
- Existing SIN application procedures are insufficient to guard against fraud and abuse. Holders of 11.8 million SINs who registered prior to the introduction of the proof-of-identity program in 1976 have not been asked to provide proof-of-identity documentation. This exacerbates the risk of misrepresentation.
- The provinces and financial institutions are required by the *Income Tax Act* and Regulations to collect SINs for tax purposes but cannot validate the SIN numbers provided by their clients.
- SIN errors, abuse, and misuse affect many federal programs, provinces and the private sector. Collectively, the impact may be sizable.
- Minimal effort is dedicated to investigations of SIN fraud and abuse, and penalties are minimal, with no real impact on deterrence.
- Unregulated use in the private sector, except in Quebec, makes it vulnerable to abuse in terms of both privacy and fraud.

16.6 The effectiveness of certain administrative decisions as well as the integrity of social programs are greatly facilitated by the reliability of the information contained in the SIN data base. We believe it is time to review the current roles, objectives and uses of the SIN in light of its governmental and societal importance. The government needs to clearly state the level of integrity and privacy protection expected in the system.

16.7 There appear to be two options: improve the existing framework to catch up with the current reality of SIN usage or else devise an acceptable alternative solution to meet the needs of users, including governments and individuals. In any case, the privacy implications need to be recognized. In our view, it is essential that Parliament play a major role in debating these issues, increasing public awareness, and finding a satisfactory solution.

Patented Medicine Prices Review Board

Chapter 17 - Main Points

17.1 The Patented Medicine Prices Review Board (PMPRB) is a small quasi-judicial board with an annual budget of approximately \$3 million and 35 full-time-equivalent employees. Created in 1987, it has a mandate to protect consumer interests and contribute to Canadian health care by ensuring that prices charged by manufacturers of patented medicines are not excessive. However, the scope of its jurisdiction and the limitations of its consumer protection role are not widely understood.

17.2 Since 1988, average annual increases in prices of patented medicines have moderated. The Board has contributed to the containment of patented drug prices, and has taken steps to assess the impact of federal price regulation. However, other factors also have contributed and we are concerned that the Board's estimates of its savings to the Canadian health care system are overstated. In reporting its results to Parliament, the Board did not clearly identify the limitations of the estimates of its own impact.

17.3 The audit identified issues pertaining to the legislative framework that need to be reviewed. The legislation is silent or unclear on certain areas. In addition, some requirements under the legislation are difficult to apply in practice, and consideration needs to be given to reviewing their continued relevance.

17.4 The majority of patented drugs sold in Canada are priced within the Board's guidelines. However, the Board needs to ensure that its price review decisions are clear and transparent. The Board also needs to identify cost-effective means to check the accuracy of price information submitted by manufacturers. Improvements are also required in the reporting of drug price trends and pharmaceutical research and development expenditures.

The Financial Information Strategy: A Key Ingredient in Getting Government Right

Chapter 18 - Main Points

18.1 Under the Financial Information Strategy (FIS), the government is making sweeping changes in the type of financial information provided to decision makers. FIS involves the move to full accrual accounting similar to that used by business firms, the implementation of new financial systems and the integration of full accrual financial information into day-to-day decision making of departmental managers. When fully implemented, by 2001 according to the current plan, FIS should help the government strengthen significantly its management of business lines and its accountability to Parliament. The government has clearly indicated that it is committed to *getting government right* and has established FIS as one important initiative in doing this. The Office of the Auditor General fully supports the stated objectives of FIS.

18.2 FIS began a decade ago. Progress in the early years was slow, but in recent years the tempo of work has picked up. To date, FIS has focussed on implementing new departmental financial systems that are Year 2000-compliant and on ensuring that departmental and central systems will provide appropriate information to include in the government's annual financial statements.

18.3 However, the government has yet to implement its plans to deal with the important area of making full accrual financial information available to officials within departments and agencies who manage business lines and related components on a day-to-day basis. One of the objectives of FIS is to provide officials with more complete information on costs to compare with results achieved when making key decisions. Until this is done, the full benefits of FIS will not be realized.

18.4 While better cost information for decision making is a benefit of FIS, we note that neither individual departments nor the government overall are aware of the full costs of FIS implementation, which could be significant.

18.5 The government and Parliament can help ensure the success of FIS by appropriating funds on a full accrual basis, so that accountability and reporting are on the same basis. But central agencies and individual departments must also act to help ensure that the full benefits of FIS are achieved. Central agencies must secure complete departmental "buy-in", and deputy ministers of individual departments must put in place the necessary infrastructure, including appropriate systems and human resources.

18.6 Departments face a major challenge in completing the renewal of their financial systems to meet the objectives of FIS. Best practices and lessons learned from others who have gone before can help achieve success.

18.7 Given the massive scale of financial systems renewal now under way to meet the Year 2000 challenge, we believe that there is a unique opportunity to put FIS in place by the 2001 target implementation date. This is not a simple task. To obtain the full benefits of FIS and thus have in place the information required for government today, the challenges faced by the government and summarized in this chapter must be met. In future audits, we will continue to track the government's progress in implementing FIS and achieving these benefits.

Electronic Commerce

Conducting Government Business via the Internet

Chapter 19 - Main Points

19.1 Research groups and experts in the information technology industry have predicted a phenomenal growth in the use of the Internet for business. In government, the Internet provides an opportunity to streamline operations and improve service delivery, as well as an alternative mode of conducting business. In a policy statement, the government committed to making electronic commerce its preferred way of doing business by 1998. In support of its agenda for “connecting Canadians”, it has also undertaken to become a model user of the information highway by 2000.

19.2 The audit focussed on the government’s use of the Internet for internal and external purposes. We concluded that progress is being made in all three areas we examined, areas that are fundamental to support electronic commerce:

- the government’s public key infrastructure project as a measure for secure electronic commerce;
- the legal framework to support conducting business electronically; and
- common technology infrastructures for interoperability and seamless access to information and services across departments and agencies.

19.3 Nevertheless, we noted several key risks that could undermine the government’s public key infrastructure project. Progress in designing business processes to make use of the Internet and developing the related computer applications is lagging behind the progress of the infrastructure project. Further, the need to certify the public, a necessary element in delivering services externally, has yet to be addressed.

19.4 A “paper bias” has been identified in the language of federal statutes and steps have been taken to resolve it. Further action is needed to manage the government’s potential legal liability in its use of electronic commerce.

19.5 A senior sponsor is needed to advance electronic commerce in government. Many issues remain to be resolved before adequate common infrastructures exist to support the delivery of services across multiple departments and agencies.

19.6 If the government does not address on a timely basis the identified risks and areas requiring action, its objective of making electronic commerce its preferred way of doing business may not be fully realized and its goal of becoming a model user of the information highway by 2000 may also be in jeopardy.

Preparedness for Year 2000

Government–Wide Mission–Critical Systems

Chapter 20 - Main Points

20.1 The Year 2000 problem was caused by the past programming practice of coding the year with two digits rather than four. On 1 January 2000, certain computer applications and devices could fail or malfunction. In 1997, we reported that the government’s rate of progress in preparing for Year 2000 had generally been slow; if it were to continue at the same rate, government systems probably would not be ready in time.

20.2 In 1998, we audited some key computer systems and devices that support six mission–critical functions in government. The functions were inspection services to contribute to food safety; emergency assistance and support; income security services; First Nations transfer payments and trust funds; border crossing services for commercial goods; and law enforcement services. We concluded that as of 30 June 1998, several key systems supporting three of those functions remained at risk of not becoming fully compliant before 2000.

20.3 We observed that the government has accelerated the pace of its efforts since our 1997 audit and has made progress in various areas, including:

- ranking Year 2000 as a top priority;
- monitoring government–wide progress of systems and devices that support mission–critical functions in government;
- advancing certain common horizontal initiatives; and
- engaging the concern of ministers and advising them of the urgency of Year 2000 efforts.

20.4 However, our review of the 30 June 1998 survey results summarized by the Treasury Board Secretariat showed “good” progress in only four departments, accounting for 7 out of 48 government–wide mission–critical functions. Nine departments and agencies responsible for 18 mission–critical functions had a score of 50 percent or less for completion of the work needed to make the systems supporting the functions compliant.

20.5 We concluded that as of June 1998, various government systems supporting mission–critical functions remained at risk. With 18 months left, we are very concerned that some essential government services may be interrupted at the start of 2000.

20.6 To ensure that mission–critical functions will continue, we recommend that the focus on Year 2000 be sustained, that the Treasury Board Secretariat consider strategic intervention as appropriate, and that contingency plans be prepared and tested for those systems that remain at risk. We also recommend that further action be taken to advance common horizontal initiatives and that reporting of Year 2000 information to Parliament be improved.

Canadian International Development Agency

Geographic Programs

Chapter 21 - Main Points

21.1 In our 1993 Report, we raised a number of concerns about the performance of CIDA's Bilateral Programs. Our 1995 and 1996 Reports contained a description of CIDA's actions to implement an ambitious program of change and renewal. In this chapter we report on the extent to which CIDA has resolved the main concerns we raised in 1993.

21.2 CIDA has adopted the concept of results-based management to change the Agency into a more results-oriented and learning organization. Progress is evident. CIDA has introduced a Results-Based Management Policy Statement, and supporting policies and guidelines have been developed and communicated to staff. It has established a Framework of Results and Key Success Factors as a guide for its managers and partners to focus more on results as they manage projects. However, progress in applying the principles of results-based management to CIDA contracts has been slow.

21.3 CIDA is in the process of developing, reviewing and updating Regional/Country Development Policy Frameworks for all major countries and regions. Some of the more recently developed Frameworks state objectives and expected results. However, the expected results are not compared with actual results, one of the key means of assessing performance.

21.4 At the project level, where official development assistance (ODA) is actually delivered, we found a greater emphasis on results, but uneven progress toward actually managing for results. Critical assumptions for project success and expected results have been articulated and a system of annual progress reporting implemented, but the statements of expected results are not always realistic. Further, once critical risks have been identified and assessed, they are not consistently monitored and addressed. This calls into question whether the expected benefits of projects will be realized. Projects are not systematically monitored after funding ends to determine whether the results expected have been achieved.

21.5 CIDA prepares internal reports on performance, reflecting its increased ability to assess and report systematically on its performance. It also submits an annual Performance Report to Parliament; this would be improved if CIDA showed progress toward results for individual projects in the context of the results expected. In reviewing the Performance Report, we concluded that more rigour is needed to ensure that information is clear, meaningful, and accurate. The delivery of ODA in a great many countries and under uncertain political and economic conditions is a very complex and challenging undertaking, one that results in varying degrees of success. We believe it is important that CIDA bring out this dimension in its reporting; a more balanced picture would enhance the credibility of its reports.

21.6 We concluded that CIDA's actions have addressed the main concerns raised in 1993. The Agency now needs to keep up its momentum in implementing management for results. It has much of the supporting framework in place. To close the accountability loop, it needs to continue working on the measurement and reporting of development results.

The Federal Science and Technology Strategy

A Review of Progress

Chapter 22 - Main Points

22.1 It has been nearly three years since the government released *Science and Technology for the New Century — A Federal Strategy*. The Strategy outlined three goals to which science and technology (S&T) resources were to be directed. It recognized the need for better management of S&T activities and provided a set of principles to improve their management in departments and agencies.

22.2 In this follow-up to our 1994 audit of the federal S&T effort, we found that progress in establishing the elements required to improve its management has, overall, been slow. The government has not acted fully on some of the commitments it made in the Strategy. As a result, the management regime set up to oversee the federal S&T effort is not yet working as intended by the government — that is, ensuring that priorities are clear, that activities are co-ordinated, and that performance is reported on fully.

22.3 In the departments we examined, progress in acting on the Strategy's seven operating principles has varied considerably. However, even the less advanced departments have moved in the direction desired by the government. More remains to be done, and our follow-up identified three areas that require special attention: mission-driven, results-based research; scientific excellence; and the use of partnerships.

22.4 Some results of the Strategy are now emerging, and we believe it may be time for the government to clearly set out what remains to be done — what is next on the agenda. Along with sufficient leadership and ongoing parliamentary oversight, this would help to ensure that the current Strategy does not become, like similar efforts over the last 30 years, one more missed opportunity.

Veterans Affairs Canada

Disability Pensions

Chapter 23 - Main Points

23.1 The disability pension program has annual expenditures of about \$1.1 billion, making it the largest program of Veterans Affairs Canada. Disability pensions are paid to approximately 151,500 recipients — 68,000 veterans, 25,500 former or current peacetime members of the Canadian Forces and 58,000 survivors.

23.2 In September 1995, pension reform legislation came into effect. The legislation resulted in fundamental changes in responsibilities for the disability pension program. The Department took on new roles in providing assistance and counselling to disability pension applicants and in adjudicating first decisions for pension claims. The Veterans Review and Appeal Board was formed at that time to hear reviews and appeals of decisions.

23.3 The main focus of the disability pension program since pension reform has been on reducing the time it takes to make pension decisions. Veterans Affairs Canada and the Veterans Review and Appeal Board have exceeded their targets for reducing turnaround times for disability pension decisions.

23.4 The quality and consistency of the services provided in the preparation of first applications could be improved through greater use of standardized guidance materials and training for all those involved in the preparation of first applications. The table of disabilities, which is used in determining the nature and extent of disability for pension purposes, provides limited guidance for assessing the extent of some disabilities. To ensure consistent and high-quality disability pension decisions, the Department needs to improve its guidance materials that facilitate entitlement and assessment adjudications.

23.5 Veterans Affairs Canada does not provide reasons for assessment decisions. There is a need for the Department and the Veterans Review and Appeal Board to regularly analyze the reasons for overturned pension decisions.

23.6 Veterans Affairs Canada is not fully utilizing the departmental review process. This process was put in place by pension reform legislation and allows certain initial decisions to be reviewed more efficiently and in less time than a formal review request to the Veterans Review and Appeal Board.

23.7 Within the next 10 years, the mix of disability pensioners will change considerably, with a significant increase in the number of former or current peacetime members of the Canadian Forces. The Department needs to inform Parliament of the changes in its client base and the strategy for addressing those changes.

23.8 Veterans Affairs Canada has assigned a high priority to its Year 2000 projects. It has a plan and schedule that is expected to achieve Year 2000 compliance for its mission-critical systems by the end of 1998. However, the Department is also dependent on other systems for information, and disruption of those systems could affect the delivery of the disability pension program.

Revenue Canada

International Tax Directorate Human Resource Management

Chapter 24 - Main Points

24.1 Revenue Canada's International Tax Directorate was established in November 1991. It is the focal point for all international tax issues (except legislative issues), with a view to enabling Revenue Canada to respond to them in a consistent and timely way.

24.2 A recent report of the Technical Committee on Business Taxation noted the following:

- In 1993, taxpayers reported to Revenue Canada \$248 billion in related-party cross-border transactions, \$166 billion of which were between related parties in Canada and the United States.
- In 1995, foreign direct investment into Canada was approximately \$170 billion, or 20 percent of assets held by Canadian businesses; and outbound foreign direct investment by Canadians was about \$140 billion, or 18 percent of total assets held by Canadian businesses.
- Even relatively small shifts in income allocated to Canada from related-party transactions have the potential to cause a significant change in the domestic revenue base.

24.3 In this complex and growing field, the Directorate requires staff who are highly skilled and who understand Canadian tax laws and tax laws in other jurisdictions.

24.4 Weaknesses in human resource management in the Directorate, coupled with the often cumbersome human resource management rules in the public service, have resulted in long delays in the competition process for staffing positions and in finalizing appointments. Skilled candidates for international tax positions at senior levels are rare, and are in demand in the private sector. Good candidates may lose interest if they have to wait long periods before being offered a position.

24.5 Currently, key positions in the Directorate — including positions of leadership — are filled by using secondments, redeployments and acting assignments. We are concerned that this approach to staffing may result in a lack of continuity and stability and may pose a risk to both the quality of work performed and the Directorate's ability to fully realize potential revenues and protect Canada's tax base.

24.6 Despite having recognized since 1994 the urgent need for a human resource plan, the Directorate is still developing a comprehensive human resource plan and strategies linked to its business plan. During September and October 1998 it initiated a number of actions that, upon completion, it expects will address certain identified problems.

24.7 Existing human resource and performance data bases need to be enhanced and better used to provide managers with information needed for human resource planning.

24.8 If Parliament approves the establishment of the proposed new Canada Customs and Revenue Agency, the Department will become a separate employer and assume most of the responsibility for human resource management. In the absence of a comprehensive human resource plan and strategies linked to the Directorate's business plan, the establishment of the new agency will not in itself resolve the problems outlined in this chapter. It is important that the analysis, planning and implementation of needed human resource initiatives be carried out as soon as possible to ensure that the Directorate can appropriately manage the risks to Canada's tax base that are inherent in international transactions.

Transport Canada

Investments in Highways

Chapter 25 - Main Points

25.1 During the last 10 years, Transport Canada has spent about \$1.6 billion on provincial and territorial highways. At the time of our audit, it was involved in 24 multi-year cost-sharing agreements with provinces and territories under the Department's various highway investment programs. Over the last five years, annual total expenditures under these programs have averaged more than \$200 million.

25.2 Each agreement under the highway investment programs is administered by a committee of one federal and one provincial official. Transport Canada has provided little or no support to guide and facilitate the work of the four departmental employees who represent the federal interest on these committees.

25.3 Our analysis of Transport Canada's performance in managing and administering its highway investment programs revealed a number of significant weaknesses. The programs themselves have been managed and administered more like grant programs than the contribution programs they are (the latter require that funding be conditional on performance and on compliance with provisions of an applicable agreement). We noted the lack of a number of sound financial management practices. We also found deficiencies in the information supplied to decision makers in support of proposed new programs. In particular, information on the condition of roads was not properly disclosed; potential environmental impacts of proposed highway programs at the strategic decision-making level were not assessed, as is required; and alternative financing arrangements by provinces were not identified, nor were their implications for traditional cost-sharing arrangements evaluated.

25.4 Further, because its environmental screening and monitoring of projects lacked rigour and were poorly documented, we could not conclude whether Transport Canada had met its statutory environmental responsibilities when assessing (screening) individual projects. Moreover, we found a number of cases in which, contrary to statutory requirements, payments had been made before environmental screenings were completed.

25.5 Despite the hundreds of millions of dollars it has spent on highway investments over the past 10 years, Transport Canada has yet to conduct a program evaluation of its highway investment programs. Accountability reporting to Parliament needs to be strengthened.

25.6 Transport Canada is at a crossroads. There has been some pressure by the provinces for the federal government to renew or confirm its position on highway investments. The Minister of Transport has said that the existing national highway policy needs to be updated. Transport Canada needs to re-examine the National Highway Transportation Policy and make recommendations to the government as appropriate.

Contracting for Professional Services

Selected Sole–Source Contracts

Chapter 26 - Main Points

26.1 To ensure that the principles of best value and open access are followed in contracting for goods and services, the government’s contracting regulations require that contracts valued at more than \$25,000 be let, except in very limited circumstances, through a competitive, open tendering process. Recent work by our Office as well as a report by the Standing Committee on Government Operations show that departments use sole–source contracts extensively. This is a matter of considerable concern because sole–sourcing works against the principle of open access and puts the achievement of best value at risk. The total value of sole–source service contracts awarded in 1995 was about \$1.4 billion.

26.2 We audited a sample from five departments of 26 sole–source contracts for professional services. We selected this type of contract because previous work had led us to believe that it was a high–risk area. Most of the contracts in our sample would not, in our view, stand the test of public scrutiny. Nor do they reflect open access to contracting opportunities with the federal government. The total initial value of these contracts was \$16 million.

26.3 In our sample of contracts we found many instances in which needs analyses, definition of requirements and procurement planning had been inadequate. Departments often underestimate the nature and scope of the work required, and do not always clearly specify what contractors are to deliver. We could find little evidence of contract management: it often appears that the contractors determine what is required, how much effort it will take and at what point the job will be considered completed.

26.4 The justifications for over two thirds of the sole–source contracts we audited did not conform to the exceptions allowed by the Government Contracts Regulations and as defined in the Treasury Board Secretariat’s Contracting Policy. This practice results in too many “one–horse races”.

26.5 Departments issue many oral contracts that remain unsigned for long periods of time. Treasury Board states that the terms and conditions of any contract issued should be in writing and should be signed as soon as possible after the contract is awarded.

26.6 In several cases departments were not able to demonstrate that their managers had, as required by the Treasury Board Secretariat’s Contracting Policy, documented and assessed the extent to which contractors had fulfilled the contract terms. In the absence of appropriate certification and documentation of what the contractors delivered, neither we nor management can be assured that due regard to economy was shown in the letting of those contracts.

26.7 In most of the contracts we examined, government regulations were not followed. Clearly, we are concerned about this. In 1997, we examined the contracting process and concluded that the current regime that governs contracting was itself sound. Similarly, the Standing Committee on Government Operations examined the contracting process and concluded that the rules were sound. The problem we found is that departments disregard the rules that apply to sole–sourcing. Moreover, disregarding them appears to involve no significant consequences for either the managers responsible or their departments. (This was the first in a series of contracting compliance audits planned by the Office.)

Grants and Contributions

Selected Programs in Industry Canada and Department of Canadian Heritage

Chapter 27 - Main Points

27.1 The Office of the Auditor General considers the proper management of grants and contributions to be an important part of good public administration within the federal government. Accordingly, the chapter presents:

- an overview of the use of grants and contributions by departments;
- highlights of the Office's observations over the past 21 years on the value for money in grant and contribution programs;
- a performance management framework that we are developing for grant and contribution programs; and
- the results of an audit, using aspects of this framework, of selected grant and contribution programs in Industry Canada and Canadian Heritage.

27.2 Our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations: problems in compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient performance measurement and reporting. Overall we have continued to find the same problems. There are many reasons why these problems have persisted. They range from decision-makers not following the rules governing expenditures on grants and contributions to weak management practices. To address this latter problem, our Office is developing a performance management framework.

27.3 We found that there are significant opportunities to improve the management of the programs we audited:

- For the Ontario Base Closure Adjustment Program delivered by Industry Canada, there was little evidence that the Department exercised due diligence in approving funding for many projects.
- We had similar concerns about Canadian Heritage's Multiculturalism Program. In about one third of the projects we audited, there was little evidence that the Department had exercised due diligence in approving funding. We are also concerned that the Program's performance expectations are ambiguous; clarification is needed to avoid duplicating the efforts of other departments and of provincial governments.

27.4 We also examined indirect delivery arrangements where a department contributes funds to an external organization that, in turn, distributes funding to the intended recipients. These arrangements require special accountability measures since departmental managers cannot rely on direct supervision and adjustment to achieve expected results. We found that Industry Canada could strengthen accountability for performance under its contribution agreements with CANARIE Inc. (Canadian Network for the Advancement of Research, Industry and Education) and PRECARN Associates Inc. (Pre-Competitive Advanced Research Network).

Follow-up of Recommendations in Previous Reports

Chapter 28 - Main Points

28.1 The amount of progress toward meeting the recommendations of previous audits covers a broad spectrum. In some cases, all significant recommendations have been addressed. In other cases, there is little or no evidence of corrective action being taken. Most cases fall somewhere between these extremes.

28.2 The following significant areas of concern remain:

- Health Canada is not in a position to effectively co-ordinate and respond to a major nuclear accident affecting Canada.
- It is not clear whether the Code of Environmental Stewardship is still in place for those agencies not required to produce a sustainable development strategy and there is also a need to involve Crown corporations in the government's greening efforts.
- We observed that adequate strategic reconnaissance is still not being conducted prior to deployment of all peacekeeping missions.
- Awareness of the potential risks to health, safety and the environment from federal contaminated sites, and the government's lack of a comprehensive plan to manage its risks and associated costs is still an issue.
- Information systems under development remain a concern due to their significance, in terms of the size of the investments and their impact on operations, and continuing delays in the planned implementation dates for certain systems.

28.3 There are also successes to report:

- Since our audit in 1996, materiel management has decreased reported inventories in four departments by more than \$480 million.
- Progress has been made in improving the quality of internal audit management.
- Revenue Canada has taken steps to ensure that excise taxes and duties on selected commodities are correctly assessed, collected and reported.
- Progress has been made in strengthening the control and accountability of the Canadian intelligence community.

28.4 We are encouraged by the amount of progress reported, and urge departments and agencies to continue their efforts in addressing our concerns until all significant matters have been resolved through corrective action.

Other Audit Observations

Chapter 29 - Main Points

29.1 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.

29.2 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.

29.3 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.

29.4 Observations reported this year cover the following:

- ongoing issues between Atomic Energy of Canada Limited and the government that need to be resolved;
- transparency and the government’s Annual Financial Report;
- concerns about poor control over computers loaned to employees for home use;
- the urgent need for an updated long-term comprehensive plan to restore and renovate the Parliamentary Precinct; and
- fairness in the Canadian income tax system.

29.5 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.

Chapter 19

Electronic Commerce

Conducting Government Business via the Internet

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Electronic Commerce

Conducting Government Business via the Internet

Main Points

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Introduction

Electronic Commerce in Government

19.7 In general, the term “electronic commerce” refers to business activities and transactions that are conducted electronically. It involves using information technology and telecommunications to disseminate information, exchange data and perform financial transactions. The term is not unique, nor is it defined specifically. Other terms that are used include E-commerce, E-business and E-trade. Electronic commerce encompasses an array of tools and technologies — such as electronic data interchange, electronic funds transfer and the Internet — that support many types of business applications.

19.8 In its public consultation documents, the federal government has offered the following definition:

Electronic commerce, which is at the heart of the information economy, is the conduct of commercial activities and transactions by means of computer-based information and communications technologies. It generally involves the processing and transmission of digitized information.

19.9 For the government, electronic commerce involves using computers and telecommunications systems in a wide range of activities — from internal activities such as administration and operations to external activities such as providing services to the public. They can be financial, such as transferring funds, or non-financial, such as providing or exchanging data and information.

19.10 Over the years, initiatives in this area (see Exhibit 19.1) have received the endorsement and support of interdepartmental senior management committees such as Treasury Board Secretariat’s advisory Information Management Subcommittee (TIMS) and the Council for Administrative Renewal (CAR).

Exhibit 19.1

Electronic Commerce: A Chronology of Major Events

1994

- Government issues technology document entitled *Blueprint for Renewing Government Services Using Information Technology*.

1995

- Information Highway Advisory Council publishes its first report containing recommendations on the government’s role as a model user of the information highway.
- Government commits to making electronic commerce its preferred way of doing business by 1998.
- Strategy paper entitled *Electronic Commerce Commitment and Agenda for Action* provides a status report on what needs to be done government-wide to do business electronically.

1997

- Throne Speech commits the government to making Canada the most connected nation in the world by 2000.

1998

- Industry Canada establishes the Electronic Commerce Task Force to co-ordinate the development of a national strategy for electronic commerce.

- Government reaffirms its commitment to become a model user of the information highway by 2000.

19.11 In particular, the Treasury Board Secretariat identified electronic commerce as a key initiative in implementing the 1994 *Blueprint for Renewing Government Services Using Information Technology*. In late 1995, the Secretariat received approval from Treasury Board ministers to implement the Blueprint.

19.12 In December 1995, the Secretariat wrote to all deputy ministers to advise them that the Board had approved the Blueprint's implementation and endorsed its specific measures and initiatives. Advancing electronic commerce was one of those initiatives. The Secretariat indicated the government's intention to publicly announce that electronic commerce would be its preferred way of conducting business. Further, the Secretariat set the direction to achieve substantial progress in conducting internal activities electronically by 1997 and external activities by 1998. The letter also noted the government's intent to become a model user of the information highway. On many occasions since then, the Secretariat has committed to making electronic commerce its preferred means of doing business with other governments, private sector organizations and Canadians by 1998.

19.13 In the September 1997 Speech from the Throne, the government made the following commitment:

We will make the information and knowledge infrastructure accessible to all Canadians by the year 2000, thereby making Canada the most connected nation in the world.

It went on to state that connecting Canadians would provide them with access to the skills and knowledge they need to benefit from the country's rapidly changing knowledge and information infrastructure. A connected nation is viewed as an important element in enabling Canadians to participate and succeed in a global, knowledge-based economy.

19.14 The Electronic Commerce Task Force at Industry Canada has been leading the move toward "connecting Canadians". In early 1998, it formulated a two-part strategy — domestic and international — to make Canada a world leader in electronic commerce by 2000.

19.15 The domestic agenda focussed on:

- building trust in electronic commerce among businesses and consumers;
- setting ground rules for the digital marketplace as necessary; and
- connecting Canadians to the digital economy by improving their access to networks, enhancing their awareness and developing their skills.

19.16 The international agenda dealt with the need for a global framework to facilitate the international growth of electronic commerce. This would include a legal framework, rules to govern the marketplace and the development of infrastructure. An immediate priority for this part of the agenda was to support the October 1998 OECD ministerial conference, "A Borderless World — Realizing the Potential of Global Electronic Commerce". Canada hosted the conference in Ottawa.

19.17 The domestic agenda further outlined a role for the government as a model user of electronic commerce. By "putting the government on-line", the Canadian federal government would become a world leader in Internet-based delivery of government information and services. This objective echoes a 1995 recommendation by the Information Highway Advisory Council. It is also consistent with the direction set by the Treasury Board Secretariat in late 1995 to make electronic commerce the preferred way of doing government business by 1998.

A Predominant Area of Future Growth

19.18 The government has been using many established technologies to replace paper-intensive and cumbersome processes, in administration and operations and in the delivery of programs and services. For example, it makes payments to millions of individuals through electronic funds transfer to their bank accounts, thereby eliminating the need to issue and process paper cheques. Taxpayers can file their income tax returns through electronic data interchange, replacing paper returns and related documents. Using kiosks and service centres, government provides key information to its clients electronically, on-site and without intervention from staff. By employing the X400 technical standard, government employees can exchange electronic messages (e-mail) across all departments and agencies. Today, e-mail has become an essential alternative to voice messages and paper mail as a means of communication.

19.19 General literature has shown that the Internet is a predominant area of future growth in electronic commerce. While statistics on Internet use are modest, the growth to date has been impressive and the potential for future growth is tremendous. In the United States, business-to-business Internet commerce grew tenfold from 1996 to 1997, when it reached US\$8 billion; a research group has predicted that it will grow to \$327 billion by 2001, a fortyfold increase. Another group has estimated that the number of U.S. companies using Internet commerce will increase from 100,000 in 1998 to 600,000 by the year 2000. A 1997 report by the Organization for Economic Co-operation and Development (OECD) noted that the most conservative private sector estimates predict a tenfold growth by 2000 in the volume of electronic commerce transacted over global information networks. Business-to-business Internet commerce is expected to be a major force in North America and Europe over the next two years.

19.20 By serving as a model user of the information highway and pursuing a domestic agenda of “connecting Canadians”, the government is helping to position Canada in a global, knowledge-based economy. Conducting business via the Internet is a key element in the government’s policy to make electronic commerce its preferred way of doing business. It provides an opportunity for new and innovative ways of interacting with the private sector, other levels of government and the public in delivering programs and services. It will help the government to meet anticipated demands from external users as access to and use of the Internet grow. Internally, electronic commerce can benefit government administration and operations by increasing efficiency and reducing costs.

Focus of the Audit

19.21 The audit focussed on the government’s use of the Internet to conduct business — both internal and external — as part of its stated policy on electronic commerce and its commitment to serve as a model user of the information highway.

19.22 The audit assessed the government’s progress in addressing three key areas that will enable it to do business over the Internet: a public key infrastructure as a measure for secure electronic commerce; a legal framework to support electronic commerce; and common technology infrastructures. In addition, we reviewed four government initiatives involving electronic service delivery, in order to identify good practices and possible lessons learned.

19.23 Further information about the audit objective, scope and criteria can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

A Public Key Infrastructure

The government's solution for secure electronic commerce

19.24 In moving from traditional paper-based transactions to electronic commerce via the Internet, users require trust and confidence that the transactions are safe and secure and that their concerns about privacy are adequately addressed. New technical tools and security measures need to be developed to support a secure environment for conducting business electronically.

19.25 In lieu of the traditional controls that provide assurance to users, different security measures are needed to keep electronic transactions safe. Cryptography provides protection in four areas, ensuring that business transactions are kept confidential (*confidentiality*), are not tampered with (*integrity*) and originate from the bona fide source that is claimed (*authentication*), and that their occurrence cannot be denied by the originator (*non-repudiation*). Exhibit 19.2 provides a glossary of selected terms related to public key cryptography services. Those terms appear in italics when they are first used in the chapter.

Exhibit 19.2

Glossary of Selected Terms Related to Public Key Infrastructure

Authentication	An assurance of identification that users are in fact who they claim to be, thereby guaranteeing that the message is legitimate.
Certificate Policy	A general statement of policy governing the operations of a <i>certification authority</i> in managing its public keys and <i>digital certificates</i> .
Certification Authority	An authority trusted by one or more users to issue and manage <i>digital certificates</i> .
Certification Practice Statement	A detailed statement of the operational procedures, standards and practices used by a certification authority in carrying out its functions under the certificate policy.
Confidentiality	A characteristic of information that is accessed only by authorized parties and no one else.
Cross Certification	A process that allows two separate <i>certification authorities</i> to agree to respect each other's certificates and keys so that their users can interact seamlessly with each other as if only one certification authority structure existed.
Digital Certificate	The equivalent of an electronic passport that holds the public key of the owner, together with basic information on the identity of that owner and, optionally, information on specific authority that may be exercised by the owner, as certified by a trusted <i>certification authority</i> .
Integrity	A characteristic of information that has not been altered in an unauthorized manner.
Non-repudiation	Based on evidence that the information has in fact been sent and received, the sender cannot successfully deny having sent it or the receiver having received it.
Root Authority	

	A trusted primary <i>certification authority</i> that certifies bodies under it as accredited <i>certification authorities</i> . It implements the approved <i>certificate policy</i> and provides a common point of reference for <i>cross certification</i> .
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Source : Adapted from Treasury Board Secretariat documents

19.26 In 1995, the government identified the need for secure and private transmission of data as a key issue that needed to be addressed. Under the direction of a subcommittee of the Council for Administrative Renewal, work was begun to establish a public key infrastructure for the government. The public key cryptography techniques use technology to encrypt, decrypt and verify data. In addition to the technical component, an infrastructure is needed to manage and co-ordinate the administration in departments and agencies of security regimes that relate to public key cryptography services.

Infrastructure development and management are under way

19.27 Under the direction of the Council for Administrative Renewal and its subcommittee, an interdepartmental working group commissioned a business case for developing a public key infrastructure for government. The business case put forward three options for deploying public key techniques, and recommended that the government adopt a government-wide solution.

19.28 The recommendation was accepted by the government. In late 1995, the Treasury Board endorsed the Government of Canada Public Key Infrastructure project (GOC PKI) and approved the related funding requirement. It was anticipated that the project would be delivered during 1998 and be ready for departmental use by December 1998. The Secretariat, as an oversight body, established and chaired a Policy Management Authority committee to set GOC PKI policies and provide a management framework for departments and agencies participating in the project. Working in partnership with a private sector firm, the government's Communications Security Establishment (CSE) played the role of project manager in the development of the technical product. The CSE was also assigned the role of *root authority*, a central facility for the government.

19.29 In July 1996, the government entered into a contract with a private sector firm to develop a GOC PKI product to meet its requirements. In June 1998, the contractor released an interim GOC PKI product. The Communications Security Establishment expected that by December this release would be accepted on an interim basis and sanctioned for use by departments and agencies.

19.30 Four of the six departments that participated in the initial funding of the project have been using early releases of a commercial version of the product on a pilot basis. They expect to upgrade to the interim GOC PKI product when the CSE provides interim approval. In addition, a number of other departments and agencies have expressed interest; some have acquired the commercial product on a limited basis and are using it in a test mode, primarily for internal secure messaging.

19.31 The Policy Management Authority (PMA) committee established for the GOC PKI in early 1996 was chaired by the Acting Chief Information Officer of the Treasury Board Secretariat. A new Chief Information Officer was appointed in March 1997 and assumed the role of Chair in December 1997. Although Year 2000, the two-digit year code problem, became a top priority of the Chief Information Officer Branch, the GOC PKI project has remained a strategic priority.

19.32 In early 1998, it was recognized that additional resources would be needed to advance the development of policies and the management framework for GOC PKI. The Secretariat established an Interdepartmental PKI Task Force that, as of July, had a staff of about 15. The Task Force director became Co-Chair of the PMA committee. By early July 1998, some 11 subcommittees and working groups had been set up, involving over 300 staff from various departments and agencies (Exhibit 19.3). In addition, the Senior Interdepartmental Lead Committee of senior government managers was struck and took on an advisory role to the PMA committee.

Exhibit 19.3 is not available, see the Report.

19.33 When we completed our audit in early July 1998 the government, under the direction of the PMA committee, had defined the need for eight *certificate policies* for GOC PKI. The policies represent four levels of security assurance: rudimentary, basic, medium and high. The PMA committee also directed the development of, and subsequently approved, a framework of elements that need to be addressed in a certificate policy and a *certification practice statement*.

19.34 The certificate policy and certification practice statements are necessary instruments to govern the implementation and management of a public key infrastructure. These instruments are essential in *cross certification*, a process designed to ensure trust and confidence among users in different organizations that use a public key infrastructure. The Interdepartmental PKI Task Force was preparing draft policies and it expected the drafts to be complete and ready for consultation by August 1998. When the certificate policies are adopted, all departments and agencies choosing to participate in the GOC PKI will develop certification practice statements that are in accordance with them.

19.35 We found, as of July 1998, that progress had been made in various areas of the GOC PKI project. An interim technical product had been released and was awaiting approval by the Communications Security Establishment; the management framework for the infrastructure component was being developed. However, we also observed several major risks to the project, which the following paragraphs discuss.

Applications using public key infrastructure have yet to be identified and developed

19.36 The business case for the GOC PKI project was prepared in order to identify options and recommend a course of action for providing public key cryptography as a measure for secure electronic commerce in government. Consequently, the options revolve around alternative ways of providing public key services. The analysis supporting the business case contemplated future requirements for public key cryptography services. However, the project has so far had limited involvement in identifying and facilitating the development of electronic business applications that would use the GOC PKI product when it becomes ready for use.

19.37 In preparing the business case, a working group conducted a survey to determine the extent of the demand in government for a public key infrastructure to support electronic commerce. The survey sampled 26 departments, agencies and Crown corporations, representing about 15 percent of government entities and some 60 percent of federal employees. In addition to the Treasury Board Secretariat about 14 entities, primarily larger departments, responded to the survey. Although the survey had attempted to directly involve government business managers and strategic business planning personnel, the survey report observed that responses from some departments had been prepared by technical specialists in information security. While the report noted that those specialists were familiar with their departments' strategic business objectives, it also acknowledged that this factor could have affected the quality of the assessment of demand.

19.38 The survey report summarized the projected demand for encryption and electronic authorization services from 1995 to 1999 by user type, such as government employee, private sector company and citizen. The requirements were also categorized by degree of certainty, from possible to likely to firm requirement.

19.39 The results showed that by 1999 there would be firm requirements for about 45,000 government employee users and 8,000 private sector company users of encryption and electronic authorization services; no firm requirements among citizen users were projected. By 1999, however, it was estimated that government employee users could exceed 110,000 and citizen users could reach 5.5 million. The cost projections in the business case were based on information from the survey report.

19.40 During 1998, the Secretariat convened several meetings to discuss the demand for the commercial product in order to plan a government-wide procurement strategy. Many departments and agencies expressed interest, but most were not ready to commit to a purchase; the product's lack of business applications was identified as a major barrier. A common application that has emerged as a driving force for using the commercial product would be internal secure messaging among employees. This is consistent with the projections made in the survey report. It estimated that of the 45,000 government employee users expected to require the services by 1999, some 25,000 would require them for internal secure electronic mail.

19.41 In the meantime, program managers and administrators in departments and agencies have been considering alternative means of delivering services and streamlining administrative and operational processes, mostly independent of the GOC PKI project. Through various interdepartmental committees and working groups, as well as senior management advisory and oversight committees, there is a general awareness and exchange of information on different business applications and initiatives being developed. Yet no direct action has been taken to co-ordinate new business processes that use the Internet with the development of corresponding computer applications and the public key cryptography services that support them.

19.42 There is a risk that the GOC PKI project will not be used to its full potential upon delivery. In our view, without direct action it is unlikely that business processes using the Internet and the corresponding computer applications will be ready when the public key cryptography services provided through this project become available and are officially approved for use in government. While the Year 2000 date code problem takes priority, action is needed to encourage government program managers and business planners to consider using the Internet as an alternative means of delivering services. Further, there is a risk that applications may focus on internal administrative and operational processes, although the government's technology Blueprint also envisioned external electronic service delivery.

Need for further analysis of implications for dealing with the public

19.43 Users of public key cryptography services need to be registered before they can be recognized as users. They are registered only after their identity, level of authority and required level of assurance are validated. Registered users are assigned unique *digital certificates*. The body that issues and manages these certificates is known as a *certification authority*. Like electronic passports, the certificates identify the specific registrants and their level of authority and assurance. They support the processes of encrypting, decrypting and verifying the transmitted data. Users under the same certification authority should be in a position to enjoy the benefit of secure transactions among themselves.

19.44 In an era of open public networks, users under different certification authorities will need to interact with one another, and certain transactions will require a secure environment. Confidence and trust in the system can be maintained only if certification authorities trust each other. This trust can be built through cross certification, a process by which the security regime and the administration of digital certificates are verified. Cross certification also involves matching assurance levels for transactions.

19.45 The process of cross certification is technical and complex and poses management challenges among different government organizations. It is a prime reason for the government to develop strict certificate policies and the infrastructure component of its GOC PKI project. The extension of public key cryptography services beyond government into the public domain further complicates the process. It also introduces many other issues.

19.46 For example, a government employee would logically be registered by either his or her own organization or another government entity charged with that responsibility. For members of the public, however, it is not obvious who the certification authority should be, nor is it a trivial matter.

19.47 If the government were to take on the responsibility of certifying members of the public, it could have each department and agency register public users of its own programs and services, or set up a single point of contact to register public users for all their transactions with different departments and agencies, or some combination of the two. Alternatively, the government could have public users register with private sector certification authorities and it could cross certify with those authorities to support secure electronic commerce transactions between the government and the public.

19.48 Each option has its advantages, disadvantages and ramifications. An every-department-for-itself approach would cause duplication and result in higher costs. In addition, members of the public might have to possess many digital certificates in order to receive services from the government or transact with it. At issue is the notion of “one user, one certificate” — that is, a public user would obtain and use a single set of certificates in doing business with the government. Whatever the government’s eventual policy on issuing certificates, some members of the public would expect the government to make every effort to minimize the number of certificates they need.

19.49 In comparison, having a single government organization serve as the certification authority for public users could raise privacy issues and exposure to legal liability for the Crown. It would necessitate maintaining a high concentration of personal information electronically on one site, introducing the risk that the government certification of a public user could be misused or abused.

19.50 If the government were to use private sector certification authorities, public users would register with them and the government would need to cross certify with each of those authorities. This would be more complex and could pose a significant challenge. In addition, the government would need to address policy issues such as whether to select private sector certification authorities for cross certification, whether to limit their number, and whether and to what extent the government ought to encourage private sector investment in this area.

19.51 Another issue is the potential cost to the public. Regardless of the certification authority chosen, costs will be incurred for the initial registration of a public user, for ongoing maintenance, and for changes and renewals as necessary. If it were a government service, the extent to which costs would be recovered through user fees would be a policy matter; if it were a private sector service, the public would likely be charged a fee. These factors will impact the services that the government wishes to provide electronically and it will need to consider them carefully.

19.52 While the demand survey supporting the GOC PKI project forecast a significant requirement for public use of encryption and authorization services, its technical architecture focussed primarily on departments and agencies. There was limited dialogue between the Policy Management Authority committee and potential private sector service providers before 1998. It was only in recent months that the implications of certifying the public began to be analyzed. A May 1998 report of one interdepartmental working group recommended that resources be allocated to conduct an in-depth assessment and feasibility analysis and to identify a preferred option for registering external users.

19.53 The issue of certifying public users is complex and has major implications. If the government does not address it in a timely manner, other options may emerge and later complicate the task of co-ordinating a common approach. This could significantly compromise the potential return on the government’s investment in its GOC PKI project and curtail the scope of secure government business conducted via the Internet.

Other development and implementation challenges to overcome

19.54 Public key cross certification is new and complex, and it has yet to be demonstrated in live applications. It calls for regimented discipline and strict adherence to certificate policies and the related practice statements. Within government, the current technical architecture contemplates seven certification authorities at the departmental level, with the Communications Security Establishment (CSE) serving as the central facility to conduct cross certification. Draft certificate policies are still being developed and have yet to be adopted by the certification authorities. The

application of cross certification could pose a major challenge to implementing the government's public key infrastructure project.

19.55 We also noted that product development is experiencing delay. The original contract called for the technical product to be delivered in 1998, in time for the government to accept it and approve its deployment by the end of the year.

19.56 The contractor delivered an interim version in June. Information provided by the Communications Security Establishment showed that an update will be provided in the fall, and interim approval for use is expected by December 1998. According to the CSE, the interim product is being tested to support the rudimentary and basic levels of assurance, and possibly the medium assurance level. A final product supporting all levels of assurance is now expected for the summer of 1999, and the government's final acceptance and approval by the end of that year.

19.57 In addition, standards for cryptography products are evolving. Through the GOC PKI project, the government has adopted certain technical standards to allow different technologies in government to operate with one another. These standards are not sanctioned by a formally accredited standard-setting organization and they are subject to market forces. Since the standards are evolving, there is a risk that they may be superseded by others, causing further delays in product development and possibly leading to incompatibility with some trading partners and parts of the private sector.

19.58 The business case for the project estimated a total cost, for 16 departments, of approximately \$35 million in the five years ending 1999, and ongoing operating costs of about \$4 million a year thereafter. The cost estimates did not allow for potential costs of technological upgrades, maintenance and support. In a rapidly changing field such as this, the understatement of annual operating costs could be significant. Furthermore, the business case focussed primarily on using cryptography within the government. The estimates did not include costs related to the certification of public users and the possible need to fund private sector certification authorities or to share costs with them. If the estimates do not reflect the full costs of a project, it will be difficult to assess and report performance at a later date. Moreover, it can call into question the project's expected return on investment.

19.59 The risks and challenges that we have noted can severely compromise the scope and use of the public key infrastructure to provide a secure environment for electronic commerce. They can undermine the government's policy of making electronic commerce its preferred way of doing business, as well as its goal of becoming a model user of the information highway.

19.60 **The government should act expeditiously to identify and develop applications requiring secure data communication. It should involve business and program managers from departments and agencies directly with the Treasury Board Secretariat's Public Key Infrastructure Task Force and the Government of Canada Public Key Infrastructure project, to optimize the use of the infrastructure in support of secure electronic commerce throughout the government.**

19.61 **The government should address concurrently the issue of certifying public users and the development of the technical product and management framework for its public key infrastructure, including consulting with the private sector and potential certification authorities for the public.**

19.62 **The government should manage the project risks that have been identified, and others as they arise. In particular, it should:**

- **implement some small applications as early as possible to demonstrate that cross certification among a small number of government certification authorities is viable and that different platforms of technology can interoperate;**
- **maintain a close watch over evolving standards to ensure that its public key infrastructure remains**

compatible; and

- **broaden the cost estimates in the business case to better evaluate the return on investment and provide an appropriate basis for making decisions and reporting performance.**

Government's response: We are pleased that the Auditor General has undertaken an audit of electronic commerce. Electronic commerce or electronic service delivery will be one of the main vehicles used to improve services to Canadians. The rapid technological advances occurring in this field make this an area that is in constant change. Since the completion of the audit in July, progress continues to be made on a number of fronts.

We agree with the need to involve business and program managers with the Treasury Board Secretariat's Public Key Infrastructure (PKI), and consultations with these groups are under way. A recently completed inventory of PKI activity across government lists over a hundred initiatives planned and/or under way. This consultation and information sharing will continue. A senior-level committee composed of business managers from across government is providing the program managers with leadership in this field.

Consultations with the provinces and with the private sector on issues such as the certification of public users and cross certification are under way. The Public Sector Chief Information Officer Council created last March is examining these issues in the context of a harmonized approach to PKI implementation across Canada. The proposed model GOC PKI certificate policy is currently under review by both public and private sector organizations.

The original implementation of PKI in seven departments to meet their internal needs was established as a formal project and is being managed as such by Communications Security Establishment. The government's move to electronic service delivery will consist of many projects initiated and managed by individual departments. The Treasury Board Secretariat will provide co-ordination and oversight to these initiatives collectively but will be careful not to compromise the accountability of the individual project managers.

The overall approach to the public key infrastructure project is to use off-the-shelf commercial software. This is cost-effective and ensures more compatibility than a made-to-order approach. The Task Force is keeping a close watch over evolving standards to ensure continued compatibility. Consultations with other bodies across the country and internationally are providing the government with up-to-date information on the current trends and activities in this field.

In developing their business cases, departments will not be making a case for PKI per se. They will be making business cases for PKI-enabled applications to meet specific business requirements. These PKI-enabled applications will permit departments to do business securely within the government, between governments and with Canadians. The government's approach is to complete Phase I, putting in place the infrastructure to support these PKI-enabled applications as they are developed and deployed.

Legal Issues

Resolution of potential limitations in legal statutes is proceeding

19.63 In 1995, a working group was tasked by the Council for Administrative Renewal to identify and address legal issues associated with the government's security strategy for electronic information. Its report provided an overview of the various legal issues involved. In March 1996, the Department of Justice mandated an Electronic Commerce Secretariat to provide legal advice on electronic commerce technology. It was recognized that there was no separate legal framework for electronic commerce and that legal and commercial frameworks designed for a

non-digital age might need to be adapted for doing business in an electronic environment. A proposed framework included three objectives:

- making statutes media-neutral (applicable to any medium);
- ensuring the recognition of secured electronic authorization; and
- revising evidence rules for electronic records.

19.64 The Department conducted a review of federal statutes for language that might indicate a paper bias. Through an electronic search of key words such as “forms”, “notarized” and “writing”, the Department found that 330 of the nearly 600 statutes contain provisions that use such terms.

19.65 Further to the review, instead of amending the statutes individually the Department’s assessment was that preparing general or global provisions would be more efficient and provide for more consistency. Among other things, the general provisions would serve as a tool for interpreting existing statutes in a media-neutral way. They would represent an additional option and would not preclude the use of paper-based mechanisms under existing statutes.

19.66 Moreover, the Department of Justice determined that the *Canada Evidence Act* ought to be amended to address the introduction of electronic records into evidence. The 1995 working group had also identified a possible need to review and amend this Act.

19.67 In early May 1998, the Department released a consultation paper entitled “Facilitating Electronic Commerce: Statutes, Signature and Evidence”. The paper put forward the Department’s proposal, as described in paragraphs 19.65 and 19.66, to resolve the potential limitations that it had identified. It expected to conclude consultations over the summer. Subsequent to our audit, the Department advised us that it had received endorsement from the government to proceed with the drafting of amendments and that the draft legislation would be ready for tabling in Parliament in the fall of 1998.

19.68 Moreover, the Department has been developing a harmonized approach with the provinces and territories. It participates in the electronic commerce project of the Uniform Law Conference of Canada. Among other matters, the Conference planned to give final approval in late August to its draft *Uniform Electronic Evidence Act*, the substance of which was being incorporated into the proposed amendments to the *Canada Evidence Act*.

Legal liability is a concern that requires further analysis and resolution

19.69 Secure electronic commerce via the Internet provides an alternative means of conducting business. However, losses and damages can occur through ignorance, negligence, abuse or deliberate attempt, and can lead to legal liabilities. The delivery of government services electronically introduces new risks and exposure that can result in legal liability for the Crown.

19.70 The need to address such potential liabilities has been generally acknowledged. In addition to legislation, the legal framework includes other instruments such as memoranda of understanding, contractual agreements and certification policies that form the basis for cross certification. Early analysis by the legal subcommittee showed that these instruments could be used to help limit the Crown’s exposure to the risk of liability. Nevertheless, the significance of legal exposure, if any, where no contractual relationship exists and third parties choose to rely on government information still needs to be determined.

19.71 Consequently, the members of the government’s legal community have suggested that every application using the public key infrastructure be preceded with a threat and risk assessment from a legal perspective. The assessment would identify and assess potential legal vulnerability so that it could be addressed accordingly, using

various instruments in the legal framework. The Policy Management Authority committee also called for participating members of the GOC PKI project to put forward various scenarios for use in further analyzing the liability issues.

19.72 The government should ensure that issues of potential liability are identified and addressed as it introduces new electronic commerce initiatives.

Government's response: New legislation will provide a framework for electronic commerce. The government is aware of concerns about liability and will ensure that departments are aware of any legal implications related to electronic commerce, including potential liability, and that they manage them accordingly.

Action Needed to Develop Direction and Adequate Common Technology Infrastructures

19.73 The *Blueprint for Renewing Government Services Using Information Technology* envisioned that the government would use information technology not only internally but to extend its services to the public electronically. Seamless access to services will require support from common technology infrastructures, so that the various technology platforms of different departments and agencies can interoperate, that is, operate readily with each other.

Senior sponsor needed to lead electronic commerce in government

19.74 To make electronic commerce the preferred way of doing business by 1998, it would be reasonable to expect that the government would follow its 1995 policy announcement with a strategic plan, led by a senior sponsor and co-ordinated with plans and actions in departments and agencies.

19.75 Under the direction of the Treasury Board Secretariat, a strategic paper entitled "Electronic Commerce Commitment and Agenda for Action" was prepared in 1995 to lead the electronic commerce initiative. The paper set out a number of initiatives and identified a number of departments and working groups that would pursue them. Because of staff turnover and changes in priorities at the Secretariat, however, many initiatives were not continued beyond 1996.

19.76 As of early July 1998, no overall strategy or plan had been developed to update the 1995 strategy and to lead the government toward its goal. There was no statement of what is to be accomplished by 1998 or what being a model user by 2000 entails. Furthermore, there was no common definition of electronic commerce in government. Departments and agencies have been developing various electronic initiatives, but no attempt has been made to co-ordinate them. Although an interdepartmental committee of deputy ministers requested that the progress of electronic commerce in government be monitored and specific information collected, there has been no attempt to do so.

19.77 The primary effort at the Secretariat to advance electronic commerce in government has been by its PKI Task Force. Although cryptography services are critical to building confidence and trust in secure electronic commerce, they are not essential for all types of internal and external transactions of government. For example, among the four electronic initiatives that we examined, only one has a stated requirement for the services afforded by the government's public key infrastructure.

19.78 Departments and agencies are advancing their own electronic commerce initiatives. To advance electronic commerce government-wide, however, there is a need for a senior sponsor to assess the government's progress and to set future direction. Without this sponsor, the government risks not achieving its policy objective and its

commitment to become a model user. More significantly, the objective envisioned in its information technology Blueprint — to renew government services using information technology — may not be fully realized.

Further efforts required for technology standards and guidelines

19.79 The Chief Information Officer Branch of the Secretariat is responsible for setting government-wide standards. Standards set by the Secretariat are promulgated as Treasury Board Information Technology (TBIT) Standards and form part of Treasury Board policies for the government.

19.80 Under the government's public key infrastructure project, progress is being made in identifying and adopting open standards that will support cross certification and the use of cryptography services. For example, standards are being set for electronic directories in government so that certification authorities could include in them electronic certificates for access by government or public users.

19.81 However, efforts to update TBIT Standards are slow. Technology standards are necessary to support common infrastructures so that different technology platforms can interoperate. Common infrastructures facilitate seamless access by the public to information and services from different departments and agencies. In Chapter 16 of our 1996 Report, we noted that many of the TBIT Standards were of questionable relevance and were being overtaken by de facto standards in the information technology industry. During the present audit, we noted that the need for standards to support common infrastructures in government had been discussed in many interdepartmental forums. But action has yet to be taken to identify the types of standards that are necessary and the specific standards to be adopted for use by government.

19.82 Through the work of an interdepartmental committee, the Treasury Board Secretariat has prepared an Internet Guide. The Guide is available on the Internet and provides technical guidance on creating websites. We found that the scope of the guidance could be broadened and that more emphasis could be placed on its use by departments and agencies.

19.83 The Guide focusses primarily on technical advice for creating websites. It also contains some guidance to help users in departments and agencies address the government principle of "common look and feel" and "ease of use". The principle of common look and feel is that websites should share certain common characteristics so that public users can readily identify that they are accessing government websites. The principle of ease of use is that websites should be easy to navigate, so that users can access information readily and efficiently. However, broader guidance on issues such as analyzing the impact of an Internet service on users and reviewing security and privacy concerns is not provided in this Guide or others.

19.84 It also came to our attention that access to and use of the Secretariat's Internet Guide were not tracked and there was no mechanism for feedback. Its length does not facilitate viewing on the Internet, and paper copies have not been disseminated.

19.85 In 1995, Public Works and Government Services Canada received approval to establish a Canada Internet site that would provide a federal government presence on the Internet. It would also provide single-window access to government information and services. The concept of a single window was discussed in the government's information technology Blueprint in 1994 and was supported by the Information Highway Advisory Council in its 1995 report. The site, <http://www.canada.gc.ca>, became operational in December 1995. Its usage has increased approximately tenfold, from about 500,000 hits per month in early 1996 to about five million hits per month in early 1998.

19.86 The Canada Internet site met the initial requirement to provide a common point of access to government information. Yet it is not user-oriented and does not facilitate seamless access to various government services, especially those involving more than one department or agency. In most instances, a user would need to know

specifically which department or agency provides which particular services in order to access them. Since its implementation, the site has remained static; changes have not gone beyond routine maintenance. The Department advised us that it is aware of the site's shortcomings and plans to address them. Subject to resource availability, it plans to adopt a client-driven orientation for the site. Since the audit, the Department has advised us that actions are under way to help users access information on the Canada site.

19.87 Two and a half years after the policy statement on electronic commerce, there is no senior sponsor to set future direction and many issues remain to be addressed in order to achieve the common infrastructures needed.

19.88 The government should appoint a senior sponsor for the goals of advancing electronic commerce in government and making government a model user of the information highway. In particular, it should consider:

- **defining electronic commerce in government;**
- **developing strategy and setting direction for electronic commerce beyond 1998, identifying deliverables and indicating when they may be completed;**
- **assigning responsibilities, clearly defining the roles and terms of reference for those assigned and supporting them with appropriate authority and resources;**
- **providing oversight and monitoring progress; and**
- **reporting performance to Parliament on a periodic basis.**

19.89 The Treasury Board Secretariat should accelerate its efforts to identify and adopt technology standards that will support common infrastructures in government. It should ensure that standards to support the government's public key infrastructure are in place and are followed when the cryptography product becomes ready for deployment.

Government's response: In April of this year the government stated that to further enhance its commitment to the principles of service improvement, it has established within the Treasury Board Secretariat (TBS) a new sector with the mandate to focus on government-wide approaches to improving services to Canadians. The creation of the new sector was initiated as part of the Secretariat's continued and concentrated effort to ensure that electronic commerce becomes the government's preferred way of doing business. The new sector is focussing on the government's priority of "connecting" Canadians and on making the information infrastructure available to all Canadians by the year 2000. The electronic service delivery channels will incorporate and make use of the public key infrastructure, the legal framework and the common technology infrastructures that are the focus of this audit.

Recently the Prime Minister indicated the government's support for electronic commerce, saying that "the federal government is not alone in tackling issues related to electronic commerce....Together with business, consumers and other governments, we are making progress on various electronic commerce issues such as taxation, intellectual property, privacy, legal frameworks and cryptography policy."

It should be noted that sponsorship is a corporate responsibility of the government, with departments playing a key role. Senior sponsorship is the responsibility of more than just one department or deputy. Electronic commerce is a new way of doing business and demands new approaches. The issues are horizontal and touch all departments. It is important to recognize this horizontal responsibility.

The government's progress in adopting electronic commerce will be reported in the Treasury Board Secretariat's annual Report on Plans and Priorities and Report on Performance.

The government is addressing the need for information technology standards. Key technology standards for secure messaging, directories, “smart cards” and documents are being examined and adopted or proposed for adoption. The establishment of additional standards to support PKI will be undertaken as the need is identified, based on their relative priorities. An internal review of the standards needed for implementation of PKI, electronic commerce and service delivery will be undertaken in the fall. This review is expected to identify a number of standards projects that should be initiated or reactivated.

Electronic Initiatives in Government — A Profile

19.90 As part of the audit, we selected and reviewed four electronic commerce initiatives in the government. The purpose of the review was to identify good practices and lessons learned from the government’s early experience in delivering services via the Internet. A brief description of the initiatives and a summary of our findings appear in Exhibit 19.4.

Four Electronic Commerce Initiatives

Electronic Initiative	MERX	Online statistics	Trade-marks	Electronic Regulatory Filing
Department / Agency	Public Works and Government Services Canada	Statistics Canada	Industry Canada	National Energy Board
Description	<ul style="list-style-type: none"> • National electronic tendering service • Developed as a co-ordinated federal-provincial action • Operated by the private sector at a fixed cost to government • Users can view and, for a fee, download data • Operational, most functions implemented 	<ul style="list-style-type: none"> • Services aimed at professionals seeking statistical data from CANSIM and other data bases • Fees charged on a full cost recovery basis • Security concerns limited to the proper billing of fees • Fully implemented 	<ul style="list-style-type: none"> • Electronic filing of applications for trademarks • High level of assurance needed on data integrity and identification of the applicant • Currently in first of four phases of development 	<ul style="list-style-type: none"> • Electronic oil and gas regulatory filing • All documents retrievable electronically on demand, resulting in significant savings to the industry • Data integrity a key concern • Entire filing and hearing processes modified with new system • Currently in pilot stage, phased implementation planned for December 1998
Good Practices	<ul style="list-style-type: none"> • Application developed with provincial government partners • Outsourced to private sector • Backup plan available during transition from previous system 	<ul style="list-style-type: none"> • Considered and used private sector solution to manage credit card payments 	<ul style="list-style-type: none"> • Developed with input from the private sector 	<ul style="list-style-type: none"> • Business case prepared and updated • Developed in close co-operation with industry and the Ontario Energy Board • Project aligned on business needs • Legal and security risks identified
Potential Lessons Learned	<ul style="list-style-type: none"> • Business case not updated • No threat and risk assessment to determine security requirements 	<ul style="list-style-type: none"> • No business case • No threat and risk assessment to determine security requirements • Legal concerns considered after initiative was implemented 	<ul style="list-style-type: none"> • No business case • No threat and risk assessment to determine security requirements 	<ul style="list-style-type: none"> • No threat and risk assessment to determine security requirements • Management of change and technical complexity continue to be risk areas

19.91 All four initiatives use the Internet in delivering government services to individuals or Canadian businesses. Three of them charge fees for services rendered. When fully implemented, two initiatives will be used to complement existing hard copy services; the other initiatives will become the only means of access to those services.

19.92 Some initiatives are in pilot mode, while others have been fully implemented. The initiatives range from the simple to the complex. They require security features in varying degrees, from being able to authenticate the identity of users to protecting the integrity of transmitted data and collecting user fees.

Good practices and potential lessons learned

19.93 One initiative involved the re-engineering of a business process in co-operation with stakeholders. The National Energy Board is developing the Electronic Regulatory Filing system with a group of private sector companies it regulates and the Ontario Energy Board. When implemented, it will change the process of filing submissions for Board hearings to one that receives submissions electronically. It will also allow potential interveners in hearings to download relevant portions of the documents for their use. Currently, a single hearing often necessitates the copying and distribution of hundreds of thousands of pages of the document by the company filing the submission. In developing the initiative, the Board took into consideration the impact on program participants (regulated oil and gas companies), other levels of government (provincial regulators) and other interveners (the public, or other private sector firms that could be affected by a submission).

19.94 Two of the initiatives we looked at considered the opportunity for private sector partnership and are now involving private sector companies in delivering services electronically. Through its MERX system, Public Works and Government Services Canada outsources the provision of information to suppliers for purposes of tendering bids for procurement contracts. The Department and participating provinces provide the content; the private sector firm develops and maintains the website and the billing system to charge and collect fees from users.

19.95 In collecting user fees for its Online statistics application, Statistics Canada uses the service of a financial institution to handle all credit card transactions. A solution internal to government would have required the use of public key cryptography services. It would also have required Statistics Canada to certify the users directly or to cross certify with the certification authorities for those users. Further, as we have noted, approval to deploy the technical product for the government's public key infrastructure is not expected until December 1999 and this would have delayed the implementation of Statistics Canada's initiative. As of July 1998, the Online statistics initiative had been functional for about two years.

19.96 The government's Enhanced Management Framework for managing information technology projects calls for the preparation of business cases. Electronic initiatives can be developed for various purposes, such as to experiment with new service delivery mechanisms, to streamline operations and reduce costs, or to respond to business pressures and user demands. Without a business case that states the desired benefits of an initiative, it would be difficult to later assess its merits. In the absence of cost estimates at the start, cost overruns and broadening of scope would be difficult to control. With one exception, we found that business cases had not been prepared for the initiatives we reviewed.

19.97 We also found that none of four departments and agencies has conducted threat and risk assessments of the initiatives. Threat and risk assessments are usually conducted to determine the level of security required for transactions and to assess alternative solutions for security. They help to identify the most appropriate and cost-effective security solution.

19.98 In our view, existing electronic commerce initiatives can provide a wealth of information for other projects. In addition to learning from the experience gained in these initiatives, other projects may use specific features and elements of them. For example, other government organizations may also have business applications that require secure filing of documents, or may also charge user fees for services. Although there is a list of electronic commerce

initiatives in government, no group has been given the responsibility to keep it up-to-date, or to review the initiatives and disseminate the experience gained to departments and agencies.

19.99 The Treasury Board Secretariat should ensure that an inventory of electronic commerce initiatives in government is maintained and updated periodically. It should analyze the initiatives for good practices and lessons learned, and share the information with departments and agencies so that they can take advantage of others' experience.

Government's response: We agree with the need to ensure that information on electronic commerce initiatives is shared across the government in order to take advantage of the experience gained by departments. This recommendation must be balanced with the need to not overburden departments with requests for more reporting. Pathfinder projects are currently highlighted by TBS. An informal inventory will continue to track initiatives and their progress.

Conclusion

19.100 The government is making progress in the areas we examined and is moving toward conducting business via the Internet by addressing barriers to electronic commerce.

19.101 In particular, it is developing a technical solution to concerns about the security of transactions conducted on open public networks. An interim product is available and is expected to receive government approval by the end of 1998. The management framework for this cryptography project is being developed.

19.102 In considering the legal framework, the government has identified language containing a paper bias in all federal statutes and is proceeding with a resolution. Through an interdepartmental committee, the Treasury Board Secretariat has produced an Internet Guide that offers technical advice to departments and agencies developing websites, and there is a Canada site that provides a federal government presence on the Internet.

19.103 At the same time, we identified several key risks that could undermine the public key infrastructure project that the government has undertaken to support its secure electronic commerce. We found that the business process using the Internet and the development of related computer applications are lagging behind the progress of the public key infrastructure project, creating a risk that it may be underutilized when it is completed. The need to certify public users and the implications of doing so present another risk. If not addressed on a timely basis, it could severely limit the use of the infrastructure to support external service delivery. Furthermore, we noted some challenges to the project's development and implementation that need to be overcome.

19.104 We also noted that electronic commerce can have important implications for the government's legal liability; further analysis and resolution of this issue are required.

19.105 Moreover, we observed that a senior sponsor is needed to advance electronic commerce in government. Many issues remain to be resolved before common infrastructures are in place to support seamless delivery of services across departments and agencies. Strategy and direction are needed to define the government's objectives and goals for electronic commerce beyond 1998. Further action will also be required to meet the government's commitment to become a model user of the information highway by 2000.

About the Audit

Objective and Scope

The audit focussed on the conduct of government business via the Internet, a predominant area of growth in electronic commerce. Government business includes administration, operations, and delivery of programs and services. The use of the Internet in conducting government business is an important part of the government's policy of making electronic commerce its preferred way of doing business. The government's commitment to serve as a model user of the information highway supports the Information Highway Advisory Council's recommendation and forms part of the platform toward Canada's goal of becoming a world leader in electronic commerce.

The audit objective was to assess the government's progress in three key areas:

- the development and implementation of a public key infrastructure for the federal government as a measure for secure electronic commerce;
- the review of and changes to the legal framework in support of transacting business electronically; and
- the implementation of common infrastructures to support government administration, operations and delivery of services via the Internet.

The audit sought to identify and highlight issues in these areas that require resolution to help advance the use of the Internet in government operations, both internally and externally. We did not audit other emerging policies such as those relating to privacy, cryptography, intellectual property and taxation. Nor have we examined the government's role and efforts in broadening public access and enhancing skills and awareness of the information highway.

We also examined four electronic commerce initiatives being pilot-tested or operating with the use of the Internet in government service delivery. They include trademarks registration at Industry Canada, electronic regulatory filing at National Energy Board, the MERX tendering service at Public Works and Government Services Canada, and Online statistics (CANSIM and trade data) at Statistics Canada.

Criteria

The general criteria used in the audit were as follows:

Security

- Clear roles and responsibilities should be established for ensuring proper safeguards for electronic commerce within and outside government.
- Risks and issues concerning electronic commerce, specifically confidentiality of information and authentication of senders/recipients, should be identified and addressed in a cost-effective manner.

Legal framework

- The legal framework should provide for appropriate definition and interpretation of records and signatures in support of the use of electronic commerce in government.

Common infrastructures

- Government-wide standards and guidelines should be in place to ensure support of electronic commerce with common technological infrastructures that offer reliability, interoperability and scalability. Policies and guidelines to effect a government-wide approach to providing electronic services should exist and be readily accessible by the intended community and easy to use.
- Measures should be in place to ensure proper conformance to standards and policies.

Selected electronic commerce initiatives

- Electronic commerce initiatives should be developed and managed to meet business needs with due regard to security, legal requirements and interoperability.

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Chapter 20

Preparedness for Year 2000

Government–Wide Mission–Critical Systems

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Preparedness for Year 2000

Government–Wide Mission–Critical Systems

Main Points

20.1 The Year 2000 problem was caused by the past programming practice of coding the year with two digits rather than four. On 1 January 2000, certain computer applications and devices could fail or malfunction. In 1997, we reported that the government’s rate of progress in preparing for Year 2000 had generally been slow; if it were to continue at the same rate, government systems probably would not be ready in time.

20.2 In 1998, we audited some key computer systems and devices that support six mission–critical functions in government. The functions were inspection services to contribute to food safety; emergency assistance and support; income security services; First Nations transfer payments and trust funds; border crossing services for commercial goods; and law enforcement services. We concluded that as of 30 June 1998, several key systems supporting three of those functions remained at risk of not becoming fully compliant before 2000.

20.3 We observed that the government has accelerated the pace of its efforts since our 1997 audit and has made progress in various areas, including:

- ranking Year 2000 as a top priority;
 - monitoring government–wide progress of systems and devices that support mission–critical functions in government;
- advancing certain common horizontal initiatives; and
- engaging the concern of ministers and advising them of the urgency of Year 2000 efforts.

20.4 However, our review of the 30 June 1998 survey results summarized by the Treasury Board Secretariat showed “good” progress in only four departments, accounting for 7 out of 48 government–wide mission–critical functions. Nine departments and agencies responsible for 18 mission–critical functions had a score of 50 percent or less for completion of the work needed to make the systems supporting the functions compliant.

20.5 We concluded that as of June 1998, various government systems supporting mission–critical functions remained at risk. With 18 months left, we are very concerned that some essential government services may be interrupted at the start of 2000.

20.6 To ensure that mission–critical functions will continue, we recommend that the focus on Year 2000 be sustained, that the Treasury Board Secretariat consider strategic intervention as appropriate, and that contingency plans be prepared and tested for those systems that remain at risk. We also recommend that further action be taken to advance common horizontal initiatives and that reporting of Year 2000 information to Parliament be improved.

Introduction

20.7 The Year 2000 problem, also known as the millennium bug, Y2K and century date change, refers to the potential for computer systems error, malfunction or failure caused by the past practice of representing the year with a two-digit code. Due to the extensive use of the date code, the information technology industry has estimated that some 90 percent of systems and codes will be affected by Year 2000.

20.8 Given the ever-increasing reliance on information technology, Year 2000 represents a business risk, not just a technical problem. It is a threat to all organizations, including businesses, non-profit organizations, schools, hospitals and all levels of government.

20.9 In 1997, we audited the federal government's overall state of preparedness for Year 2000. We concluded that as of 30 April 1997, the government's rate of progress in addressing the Year 2000 threat had generally been slow.

20.10 We were concerned that if progress were to continue at the same rate, it would likely be too slow to ensure that government systems would be ready in time. We concluded that Year 2000 remained a serious threat to essential programs and services and that urgent and aggressive action was required.

20.11 We recommended that the Treasury Board Secretariat give top priority to monitoring progress. In particular, we recommended that it identify the systems considered to be mission-critical to the government as a whole and intervene strategically as appropriate, to ensure that they would be ready before 2000. We also emphasized the need for contingency plans. Other recommendations included:

- ranking Year 2000 as a top priority;
- affirming the sustained commitment and support of senior management;
- informing Parliament of the potential impact of Year 2000 and reporting on progress toward making systems compliant; and
- accelerating common initiatives that support Year 2000 work in departments and agencies.

Focus of the audit

20.12 The current audit focussed on the government's progress in making its mission-critical systems compliant for Year 2000.

20.13 We used the results of the Treasury Board Secretariat's 30 June 1998 survey to obtain an update of the government's progress in making compliant the systems that support its mission-critical functions. We examined several key systems and applications that support six government-wide mission-critical functions. We also followed up on action taken by the government to address our 1997 recommendations.

20.14 Further information about the audit objective, scope and criteria can be found at the end of the chapter in **About the Audit**.

Observations and Recommendations

Examination of Systems That Support Government–Wide Mission–Critical Functions

20.15 In July 1997, the Treasury Board Secretariat prepared an initial list of government–wide mission–critical functions — those considered essential to delivering programs and providing services. The list was circulated to all deputy ministers and heads of agencies for feedback. The departments and agencies responsible for the functions were also requested to provide a brief impact statement on each of the functions.

20.16 In the fall of 1997, the list included 19 departments and agencies that provide 44 mission–critical functions of the government. Those functions became the focus of the Secretariat’s subsequent survey efforts. Year 2000 work on them receives priority access to resources such as funding, and to procurement arrangements. As of June 1998, 48 government–wide mission–critical functions had been identified; they are provided by 21 departments and agencies and two Crown corporations (Exhibit 20.1).

Exhibit 20.1

Government–Wide Mission–Critical Functions

Department, Agency or Crown Corporation	Function
Atomic Energy of Canada Limited	<ul style="list-style-type: none"> control, safety, monitoring and facilities management
Canadian Broadcasting Corporation	<ul style="list-style-type: none"> communications and broadcasting system
Canadian Food Inspection Agency	<ul style="list-style-type: none"> food production and inspection
Canadian Heritage (Parks Canada)	<ul style="list-style-type: none"> maintenance management system
Canadian Security Intelligence Services	<ul style="list-style-type: none"> security intelligence security screening
Citizenship and Immigration Canada	<ul style="list-style-type: none"> managing access to Canada
Communications Security Establishment	<ul style="list-style-type: none"> foreign intelligence and information technology security
Correctional Service Canada	<ul style="list-style-type: none"> offender reintegration
Environment Canada	<ul style="list-style-type: none"> environmental forecasting system
Fisheries and Oceans	<ul style="list-style-type: none"> Canadian hydrographic service icebreaking operations marine communications and traffic services fleet management marine navigation services rescue, safety and environmental response
Foreign Affairs and International Trade	<ul style="list-style-type: none"> consular affairs export and import controls Canadian passport office network (messaging system)
Health Canada	<ul style="list-style-type: none"> laboratory centre for disease control therapeutic products program food program environmental health program medical services
Human Resources Development Canada	<ul style="list-style-type: none"> income security

	<ul style="list-style-type: none"> • employment insurance
Indian and Northern Affairs Canada	<ul style="list-style-type: none"> • band support funding
Department of Justice	<ul style="list-style-type: none"> • family orders and agreements enforcement
National Defence	<ul style="list-style-type: none"> • defending Canada • defending North America • contributing to international safety • support to operations • support to broad government programs
Natural Resources Canada	<ul style="list-style-type: none"> • aeronautical and technical services • seismic monitoring • geomagnetic monitoring
Public Works and Government Services Canada	<ul style="list-style-type: none"> • public service compensation • Receiver General services • processing government financial transactions
Royal Canadian Mounted Police	<ul style="list-style-type: none"> • law enforcement
Revenue Canada	<ul style="list-style-type: none"> • social income redistribution • income tax processing • customs border services and trade administration
Tax Court of Canada	<ul style="list-style-type: none"> • appeals management system
Transport Canada	<ul style="list-style-type: none"> • transport regulation
Veteran Affairs Canada	<ul style="list-style-type: none"> • health care • pensions and allowances

Source: Treasury Board Secretariat, June 1998

20.17 In assessing the government's progress, we selected for examination six government-wide mission-critical functions by applying the criteria used in our 1997 audit. These functions include:

- inspection services to contribute to food safety;
- emergency aid to civil powers and assistance and support in the event of natural disaster or loss of civilian infrastructure;
- income security services to seniors;
- transfer payments to First Nations and management of their trust funds;
- border crossing services for commercial goods, including collection of and accounting for customs duties and the goods and services tax; and
- law enforcement services for the safety and security of the public.

20.18 Government-wide mission-critical functions are supported by many computer programs, systems and devices that vary significantly in size and complexity. In early 1998, the Chief Information Officer at Treasury Board Secretariat estimated that over 1,000 systems support these functions. In each of the six functions we selected, we attempted to identify for audit the most critical systems, including embedded devices (those that require micro-processors to make them operational).

20.19 In some functions we audited the lead system; in others, we selected and audited up to three key applications and systems. All the selected systems and devices are considered necessary to support the mission-critical functions but not always sufficient to ensure that the functions will continue. Our findings pertain only to the

systems and devices that we audited and are not representative of overall progress in the organizations where they operate. Our findings reflect the status of progress at 30 June 1998 (31 August 1998 for emergency assistance and support).

Canadian Food Inspection Agency — inspection services for food safety and animal and plant health

20.20 Food inspection services help maintain Canada’s high standards of quality and safety for food, agricultural inputs, and animal and plant health. The Canadian Food Inspection Agency depends extensively on information technology to carry out inspection, testing and certification of food products. Its systems that support food inspection are mission-critical because their potential failure or malfunction could result in health and safety concerns.

20.21 The Canadian Food Inspection Agency was created in 1997 to consolidate the food inspection and animal and plant health activities of three federal departments. To address the Year 2000 threat, the Agency decided to develop new information systems, including the Multi-Commodity Audit Program (MCAP) and Laboratory Sample Tracking Systems (LSTS), in the place of existing systems from three departments (Exhibit 20.2). Further, the Agency needed to test and replace laboratory equipment where necessary to make it Year 2000 compliant.

Exhibit 20.2

Canadian Food Inspection Agency — Inspection Services for Food Safety and Animal and Plant Health

Systems selected for audit	<ul style="list-style-type: none"> • Multi-Commodity Audit Program (MCAP) — audit inspection module • Laboratory Sample Tracking Systems (LSTS) • laboratory equipment — level 4 laboratory, disease control laboratory in Winnipeg
Relationship to mission-critical function that they support	MCAP supports the audit and inspection function, replacing mission-critical systems to support inspection of all commodities including meat and fish. The LSTS supports sample tracking and manages analyzed results. The laboratory equipment supports the analysis of food and other samples.
Systems description	Two mission-critical subsystems of MCAP have about 100,000 lines of code each. Three mission-critical subsystems of LSTS have between 100,000 to 200,000 lines of code each. The systems operate in a client/server environment. The Agency has over 2,000 pieces of laboratory equipment that can be susceptible to the Year 2000 problem.
Status (30 June 1998)	For subsystems of audit and inspection module in MCAP, some were in development phase; some were being tested. All subsystems in LSTS were in development phase. For its laboratory equipment, the Agency was in the process of following up with equipment manufacturers and vendors and testing embedded devices.
Testing plans and strategy	The Agency has a Testing and Certification Protocol for its information systems, information technology infrastructure and embedded systems. It has an overall test strategy but individual test plans were not available.
Planned completion dates	June 1999 for MCAP and LSTS; October 1998 for laboratory equipment

20.22 We noted that implementation dates for the MCAP systems were delayed by about four months from earlier plans. The Year 2000 effort for laboratory equipment also experienced delays.

20.23 We found that the Agency had identified interdependencies among its Year 2000 efforts on individual systems. However, analyses of these interdependencies for completion timeline and critical path modelling were incomplete. We were advised by the Agency that it had attempted to conduct these analyses but had not been able to

complete the task, due to a number of factors such as time and costs. As a result, there is no critical path for the Agency's overall Year 2000 project. Further, as of June 1998, it had yet to begin reviewing its interdependencies with other countries.

20.24 Although the Agency has a defined protocol for testing and certification of its information systems and technology infrastructure and has developed an overall test strategy, it has not prepared test plans for the individual systems. As of 30 June 1998, it had yet to finish establishing a Year 2000 test environment. These environments are established to simulate processing in 2000. Systems are not considered fully compliant for Year 2000 purposes until they have been tested successfully in this type of environment.

20.25 Some application systems can have failure dates prior to 2000. We observed that the Agency's analysis of the possibility of early failure of its application systems was insufficient and required further work. We noted that one application in LSTS that experienced failure due to the date code had not been identified in the Agency's analysis.

20.26 The Canadian Food Inspection Agency has over 2,000 pieces of laboratory equipment. Many of them contain microprocessors that can be difficult to detect and test, complicating the work of making those systems compliant for Year 2000. In most cases, communication with and guidance from the suppliers will be required. The Agency contacted suppliers of its laboratory equipment but, when we completed our audit, it had not received responses from about two thirds of them.

20.27 The target completion date for the Agency's Multi-Commodity Audit Program (MCAP) and Laboratory Sample Tracking Systems (LSTS) is June 1999. While this meets the milestone date stipulated by the Treasury Board Secretariat, it does not provide room for further slippage or for unexpected problems with various data interfaces among systems. The testing and replacement of laboratory equipment were planned for completion at 30 October 1998. Given that the needed vendor responses on most of the Agency's laboratory equipment had yet to be received by the end of the audit, completion by October 1998 was unlikely and no new target date had been set. Thus, in our view, the MCAP and LSTS systems and the laboratory equipment remained at risk of not being fully compliant in time for Year 2000.

20.28 The Year 2000 project office at Treasury Board Secretariat requested departments and agencies with systems that support government-wide mission-critical functions to complete and submit a Year 2000 risk assessment by 31 August 1998, to determine if contingency plans would be necessary. At the time of our audit, the Canadian Food Inspection Agency was planning to assess its Year 2000 risks and prepare detailed contingency plans by the end of August 1998. Subsequent to the audit, the Agency advised us that it expected the two systems and its laboratory equipment to be fully compliant in time for Year 2000.

National Defence — emergency assistance and support

20.29 National Defence is responsible for five government-wide mission-critical functions. In early 1998, as part of its Operational Readiness program, it commissioned a series of impact analyses for 12 representative missions that it needs to undertake from time to time. One such national mission is to provide emergency aid to civil powers and assistance and support in the event of natural disaster or loss of infrastructure. The 1997 Red River flood in western Canada and the 1998 eastern Canada ice storm are examples of the events that this type of mission would support.

20.30 The impact analysis for this representative mission was completed in late June 1998. The analysis identified 31 essential systems, 17 of which were categorized as "very high priority". We selected three of the 17 systems for examination — Joint Establishment and Movement Management System (JEMMS), Automated Defence Data Network (ADDN) and National Materiel Distribution System (NMDS). The JEMMS generates task force movement tables to support the movement of staff and equipment in a planned mission. The ADDN provides

messaging capability seven days a week and 24 hours a day to facilitate secure and reliable communication in times of peace and war. The NMDS produces documents for distribution of materiel, and tracks shipments (see Exhibit 20.3).

Exhibit 20.3

National Defence — Emergency Assistance and Support

Systems selected for audit	<ul style="list-style-type: none"> • Joint Establishment and Movement Management System (JEMMS) • Automated Defence Data Network (ADDN) • National Materiel Distribution System (NMDS)
Relationship to mission–critical function that they support	The three systems support the movement of personnel and materials needed for planned missions and facilitate communication by providing a secure messaging capability.
Systems description	The JEMMS system is a stand–alone PC–based application that was developed in 1996. The ADDN has two nodes in Ottawa. It communicates with 80 widely distributed personal computers and has data links to other agencies and allied countries. The NMDS operates on 45 minicomputers that are connected via the Department’s integrated data network. It supports about 250 terminals that are located at two supply depots and all departmental shipping and receiving areas. The NMDS system is also located abroad and has mobile systems that are connected via satellite.
Status (31 August 1998)	The JEMMS was certified as Year 2000 compliant in August 1998. Code check for ADDN was completed and testing was continuing; non–compliant ADDN personal computers were identified. The NMDS system was in conversion.
Testing plans and strategy	Test plans completed for ADDN. Although testing checklist exists, test plans have not yet been prepared for NMDS.
Planned completion dates	28 February 1999 for ADDN; 31 March 1999 for NMDS

20.31 During the planning phase, the Department found that the Joint Establishment and Movement Management System (JEMMS) had been developed in 1996 using programming tools that were Year 2000 compliant. The JEMMS operates on personal computers. Although the personal computers at National Defence Headquarters are Year 2000 compliant, in August 1998 those at the Department’s bases and stations were being tested and replaced as necessary. Also in August 1998, the systems manager and the director certified that JEMMS does not use dates. Since the audit, the Department has advised us that JEMMS will be considered compliant after the hardware at its bases and stations are confirmed or made compliant.

20.32 By August 1998, programming codes in the Automated Defence Data Network (ADDN) had been verified and were undergoing testing. National Defence has requested and received confirmation of Year 2000 compliance from suppliers of the core software and hardware. About 15 older personal computers have been identified as non–compliant. The Department plans to apply a software solution to address the problem and to not replace the computers at this time. At the end of our audit, it was expecting to complete the software correction by November 1998. According to departmental officials, the ADDN system and other messaging systems in the Department are expected to be phased out and replaced by a new departmental message–handling system in 2001.

20.33 The technology platform for the National Materiel Distribution System (NMDS), including hardware, software and the data base, has been assessed as non–compliant and needs to be replaced. In addition, the existing hardware that supports NMDS has experienced more frequent breakdowns in recent years. The Department plans in April 1999 to phase out its integrated data network, the network used by NMDS.

20.34 The Department prepared detailed project plans to redevelop NMDS and reinstall it on a compliant technology platform; at the end of our audit, the redevelopment work was on schedule. Test plans for NMDS are not scheduled to be completed before February 1999.

20.35 Some risks of delay are involved in replacing non-compliant data terminals and procuring and installing work stations to access the Department's wide area network. This could delay in turn the completion of Year 2000 conversion and testing of NMDS.

20.36 In our view, the risks facing the three systems that we examined are not significant in comparison with the risks to other systems in the Department or to others we examined in other departments and agencies. Year 2000 risks are higher in the Department's large information technology projects and the large number of embedded devices. Over 80 percent of its systems are embedded systems; when we completed our audit, its inventory list was still being updated.

20.37 Under the Department's Operational Readiness program, impact and risk analyses for representative missions were to continue in the fall of 1998. As of 31 August 1998, the Department considered that no contingency plans were necessary for the three systems we audited. Subsequent to the audit, the Department indicated that it was planning a number of activities to reduce risk in its embedded systems. It also advised us that it would prepare contingency plans for the three systems and develop business continuity plans under the Operational Readiness program.

Human Resources Development Canada — income security services

20.38 Income security services at Human Resources Development Canada include the Canada Pension Plan (CPP) and the Old Age Security program. For many seniors who depend on benefit payments as part of their retirement income, services that provide those payments are essential. The CPP provides 3.7 million benefit payments to eligible contributors and to surviving spouses and dependent children (Exhibit 20.4).

Exhibit 20.4

Human Resources Development Canada — Income Security Services

Systems selected for audit	Canada Pension Plan (CPP) system — Earnings, Benefits and Payments subsystems
Relationship to mission-critical function that they support	The system manages information relating to the Canada Pension Plan and provides benefit payments to eligible contributors or their beneficiaries.
Systems description	The three subsystems are legacy systems with about 2.4 million lines of code. They operate in a mainframe COBOL environment.
Status (30 June 1998)	The Department was testing the Earnings subsystem and a portion of the Benefits subsystem for quality assurance and acceptance. Portions of Benefits and Payments subsystems were in conversion.
Testing plans and strategy	Test strategy exists; test plans for Year 2000/MVSK environment have yet to be completed.
Planned completion dates	31 December 1998

20.39 Over the past few years, under an initiative to redesign the information systems for its income security programs, Human Resources Development Canada compiled a full inventory of the CPP system. While the redesign project was under development, the Department started Year 2000 repair work on the existing CPP system as a contingency measure. When the redesign project was halted in late 1997, the Year 2000 strategy focussed on

repairing the CPP system. The conversion strategy involved using a combination of a four-digit year code and program logic for two-digit codes. The repair work on the three subsystems was concurrent, and completion was planned in sequence — Earnings, Benefits and then Payments. The Department also used a phased approach to repairing and testing the subsystems.

20.40 As of June 1998, repair work on the Earnings subsystem was almost complete and the repaired codes were undergoing tests for quality assurance and acceptance. We noted a minor slippage in the repair work for the Benefits subsystem: 73 percent of the programming codes had been converted by the end of June 1998. Code conversion for the Payments subsystem was about one month behind. At 30 June 1998, just under half the codes had been converted and the completion date had been rescheduled to mid-November 1998.

20.41 The Department completed its analysis phase of the three CPP subsystems in February 1998. According to its plans prepared in late February, quality assurance and acceptance testing of the Benefits and Payments subsystems was to occur over approximately 14 months. The planned 14 months included testing for CPP legislative changes passed by Parliament in December 1997. As work on those two subsystems progressed, the plans were revised each month. As of June 1998, about 20 percent of the Benefits subsystem had been tested for quality assurance and acceptance and those tests had not begun for the Payments subsystem.

20.42 The testing of systems in a Year 2000 test environment is a critical step in ensuring compliance and readiness. Thus, once established, such a test environment becomes an important resource and often its use is scheduled to full capacity. Human Resources Development Canada has arranged to test its three CPP subsystems in a Year 2000 test environment (called MVSK), which is managed by another department. The testing of the CPP system in that environment is scheduled from mid-October to 31 December 1998. In addition to supporting its own Year 2000 testing, the department managing MVSK has set up a tight schedule to support its other client departments and agencies.

20.43 Before testing in the Year 2000 environment, code conversion and quality assurance and acceptance testing need to be completed. There is a risk that those steps may not be finished in time for the MVSK testing. In the event that the CPP subsystems are not fully ready, Human Resources Development Canada could miss its scheduled MVSK testing and have difficulty rescheduling. As of June 1998, it appeared that the Department would need to compress its quality assurance and acceptance testing process to meet the MVSK schedule. Compressed testing could increase the risk of failure in the Year 2000 test environment; it could also cause functionality problems after the converted subsystems are implemented.

20.44 Quality assurance and acceptance testing is an essential step. We noted that as of June 1998 the testing team was not fully staffed and the quality assurance and acceptance testing of some functions in the CPP subsystems had yet to be assigned. Although detailed plans for quality assurance and acceptance testing were in place, plans for testing in the Year 2000 environment (MVSK) were not complete.

20.45 System interfaces for the CPP system were identified during the redesign project and were subsequently confirmed as part of the Department's Year 2000 project. Work on the interface of the Earnings subsystem with data on CPP contributions has been co-ordinated with another department. Human Resources Development Canada has requested and received a copy of the Year 2000 plans for the government's payment system, which interfaces with its Payments subsystem; periodic meetings have been held since December 1997 to co-ordinate testing activities between the two systems.

20.46 Human Resources Development Canada's plan is to make the CPP system fully compliant by December 1998, leaving up to one year to address any slippage or problems encountered during testing. As of 30 June 1998, quality assurance and acceptance testing was ongoing; it was uncertain whether testing in MVSK would be completed successfully by 31 December 1998. In our view, there remains a risk that some of the CPP subsystems may not be fully compliant before 2000. If the CPP subsystems fail to pass MVSK testing in 1998, the Department has indicated that it will retest the changes and corrections for quality assurance and acceptance and then retest in

MVSK. In that event, it will implement a detailed contingency plan to ensure that the essential service of providing CPP benefit payments will continue in 2000.

20.47 As we completed our audit, Human Resources Development Canada was intending to prepare a risk assessment by the end of August 1998, as requested by the Treasury Board Secretariat. The Department indicated that it was confident that the CPP system would be compliant by the end of December 1998. It also indicated that, in any event, it would finalize detailed contingency plans.

Indian and Northern Affairs Canada — First Nations transfer payments and trust funds

20.48 First Nations transfer payments support basic services on reserves, such as education, social assistance, housing and other capital facilities. Transfer payments are also made pursuant to comprehensive land claims and specific claims. In fulfilling the government's fiduciary responsibilities, Indian and Northern Affairs Canada also provides trust services, including the management of Indian moneys as stipulated in the *Indian Act*. These are essential services for Aboriginal peoples and a mission-critical function of the government.

20.49 The Transfer Payment Management System (TPMS) and the Trust Fund Management System (TFMS) are the primary systems supporting this function. We also examined the Departmental Accounting System (DAS) because both TPMS and TFMS interface with it (Exhibit 20.5).

Exhibit 20.5

Indian and Northern Affairs Canada — First Nations Transfer Payments and Trust Funds

Systems selected for audit	<ul style="list-style-type: none"> • Transfer Payment Management System (TPMS) • Trust Fund Management System (TFMS) • Departmental Accounting System (DAS)
Relationship to mission-critical function that they support	The TPMS manages and provides funding of \$3 billion annually to over 600 First Nations. The TFMS accounts for trust funds of about \$1 billion that the Department manages on behalf of First Nations. Both systems interface with DAS, the accounting system for the Department.
Systems description	All three are customized systems. TPMS and TFMS were developed in the 1980s, with 600 modules and about 260 modules respectively; DAS was redeveloped using PowerHouse and C language and has about 50,000 lines of code.
Status (30 June 1998)	The technology environment was being upgraded. The TPMS and TFMS were in conversion and a Year 2000 compliant version of software has been installed for DAS, with testing to follow.
Testing plans and strategy	Testing strategy exists for the three systems but not detailed plans
Planned completion dates	31 December 1998

20.50 Treaties with First Nations date back to the 18th century; funding arrangements span many years. Consequently, application systems like TPMS and TFMS were developed using an eight-digit date code. Indian and Northern Affairs Canada determined that some conversion work was needed for data display and reporting. Independent of its Year 2000 work, the Department was also changing its operating system and data base standard. The change involved a conversion of the Departmental Accounting System (DAS), which was considered Year 2000 compliant by the supplier. After conversion, the system would need to be tested using the new technology platform to ensure that it would be Year 2000 compliant.

20.51 We found that the Department had not addressed the Year 2000 problem on a department-wide, business-oriented basis. Under the direction of its Information Management Branch, the Department's Year 2000 project activities at the time of our audit focussed primarily on managing changes in the areas of its corporate information systems and technology. Only at the end of June 1998 did the Department formally appoint a senior sponsor to direct its Year 2000 project and take on a department-wide perspective.

20.52 Indian and Northern Affairs Canada prepared a master list of software systems — an inventory list of corporate systems — during the planning phase of its Year 2000 project. However, we found that the list did not identify all the significant systems that interface with those in the inventory list. The Resource Management Information System (RIMS) was omitted — a local system that serves as the primary source of data input to the Trust Fund Management System (TFMS). In addition, the list of interfaces for DAS did not include the linkage with the government's payment system or the central accounting system. As a result of our audit observation, the Department has added RIMS and those linkages to its inventory of Year 2000 work.

20.53 We found that work plans have been prepared for all three mission-critical systems. However, they do not contain details of the activities to be performed and the corresponding resources needed. Thus, it will be difficult for the Department to monitor progress and assess the adequacy of the estimated resource requirement. We also noted that test plans for the systems have not been prepared.

20.54 In our view, the Year 2000 risks to TPMS, TFMS and DAS are lower than the risks to some of the other mission-critical systems we examined. In comparison with others, these systems are less complex. When we completed our audit, the Department had six months remaining to complete its conversion work and test the systems by its target date of December 1998. Both TPMS and TFMS now use an eight-digit date code and DAS has been upgraded to a version that is considered Year 2000 compliant.

20.55 At the end of our audit, Indian and Northern Affairs Canada was planning to complete a risk assessment by 31 August 1998 for submission to the Secretariat. According to the Department, preparation of an information technology contingency plan and a business contingency plan would follow.

Revenue Canada — border crossing services for commercial goods

20.56 Revenue Canada's customs service administers over 80 acts and regulations on the government's behalf at border crossings. For commercial goods, the responsibilities vary from facilitating shipment and import of commercial goods to intercepting illicit drugs and other banned substances. Customs processes over 11 million commercial entries annually, accounting for about \$20 billion in customs duties and the goods and services tax. It is a mission-critical function that not only provides an essential service to importers but can also affect public health and safety and Canada's finances.

20.57 The Customs Commercial System (CCS) operates on a continuous basis. It maintains an inventory of all commercial entries and directly supports the processing of and accounting for the goods. Further, it interfaces with the Accelerated Commercial Release Operating Support System (ACROSS), a departmental system that supports customs officers in making decisions on the release of goods (Exhibit 20.6).

Exhibit 20.6

Revenue Canada — Border Crossing Services for Commercial Goods

Systems selected for audit	Customs Commercial System (CCS)
Relationship to mission-critical function that they support	CCS is a key system that supports services at border crossings for the import of commercial goods. Its functions include keeping inventory, processing, accounting for and control of

	those goods.
Systems description	CCS consists of 4,283 modules with about 1.6 million lines of code. It operates in a mainframe MVS/DB2 environment.
Status (30 June 1998)	Conversion phase for CCS had been completed. The system was in integration testing and testing for user acceptance.
Testing plans and strategy	Testing plans and strategy were completed.
Planned completion dates	30 October 1998

20.58 The Year 2000 conversion strategy for CCS involved repairing existing codes. The Department decided to implement the repaired codes in a single release.

20.59 Over the years, in meeting the need to update the tax code annually, Revenue Canada has developed a structured methodology for testing code changes. In preparing for the testing phase of its Year 2000 project, it augmented its regular testing process with a Year 2000 testing environment (called LPAR). This initial testing strategy was reviewed by an information technology firm, which recommended adding a test environment called WT. The WT environment is capable of automated date manipulation to age data. It can help identify major problems in an application before the Department tests it in its LPAR environment.

20.60 The recommendation was accepted, bringing the testing process for Year 2000 to four phases of regular testing as well as testing in the two Year 2000 environments. Revenue Canada has a department-wide definition of Year 2000 compliance. Systems are certified for Year 2000 only if they have met the compliance definition, tested successfully for user acceptance and in the LPAR environment, and been reintroduced in the normal operating environment.

20.61 We found that repair work on CCS had been completed, and the system was in testing at the time of our audit. Testing in the LPAR environment was scheduled for October 1998.

20.62 We note that there has been some slippage in the deadlines for testing and that the time allowed for the testing phases has been compressed. In particular, as of 30 June 1998, the WT integration testing had not been completed and the objective of conducting WT testing — to identify and correct major problems early in the process — had not been achieved.

20.63 Revenue Canada's Information Technology Branch noted in February 1998 that testing was becoming the bottleneck for Year 2000 projects in industry as well as in the Department. It stated that its LPAR testing schedules were not negotiable. As a result, at the time of our audit there was a risk that the CCS might not undergo sufficient testing prior to being tested in the LPAR environment in October 1998 and that problems could arise during that critical phase. Thus, there was a risk that CCS would not achieve Year 2000 certification by the planned date.

20.64 We noted that two releases of CCS have been planned for 1999; the first is scheduled for January. In the event that CCS failed to achieve Year 2000 certification in October 1998, the Department was planning to certify the system in early 1999.

20.65 Although some risks exist for CCS, in our view they are lower than the risks to some of the other systems we examined in this audit. If CCS failed to achieve Year 2000 certification in October 1998, it would have to be given priority for LPAR testing in 1999 and the Department would need to consider undertaking risk assessment and contingency planning. Subsequent to the audit, the Department advised us that its certification testing for CCS was near completion and the system was on schedule to be implemented in October 1998 as planned.

Royal Canadian Mounted Police — law enforcement services

20.66 Law enforcement services support law and order and provide for the safety and security of the public. Thus, they form part of the government's mission-critical functions. The Canadian Police Information Centre (CPIC), a system that supports policing service across Canada, is maintained by the Royal Canadian Mounted Police (RCMP) and is used by its 700 detachments and over 500 other agencies (Exhibit 20.7).

Exhibit 20.7

Royal Canadian Mounted Police — Law Enforcement Services

Systems selected for audit	Canadian Police Information Centre (CPIC) system
Relationship to mission-critical function that they support	CPIC maintains information and provides it on demand to police officers in support of law enforcement activities in crime prevention, investigation and pursuit of criminals.
Systems description	CPIC was designed about 25 years ago. It has approximately 750,000 lines of code and operates in a mainframe COBOL environment
Status (30 June 1998)	Conversion to MVS COBOL was in testing; conversion of application systems and modules had started.
Testing plans and strategy	The testing plans and strategy were being developed.
Planned completion dates	31 March 1999

20.67 The Year 2000 strategy for CPIC involved two phases:

- converting the application and operating systems from COBOL to MVS COBOL; and
- repairing application systems using a four-digit year code.

20.68 Many application systems use forward dates and can fail or malfunction prior to 2000. The CPIC modules that could be expected to fail in January 1999 have been identified. Since the conversion strategy involves repairing codes module by module, those with a potential early failure date have been given priority.

20.69 We found that the RCMP has an overall Year 2000 project plan for the entire CPIC system. Activities in that plan range from one week to many months in duration. In the absence of detailed plans, it is difficult for the Year 2000 project office to assess whether scheduled dates for task completion are reasonable, and to monitor progress. In these circumstances, any delays could go undetected for months.

20.70 As of June 1998, there had been only minor slippage in the first phase of converting to MVS COBOL. But phase two, year code conversion, had experienced a three-month delay. Although the overall project plan had been updated accordingly, which changed the target date for full CPIC compliance from 31 December 1998 to 31 March 1999, target dates for some key activities had not yet been set.

20.71 The RCMP has established a Year 2000 test environment (called LPAR), and some guidelines exist on testing applications for specific dates. A Year 2000 test plan and a test strategy, including co-ordinated testing with external users, were still being developed at the time of our audit.

20.72 The CPIC system is used extensively by the RCMP and other organizations involved in law enforcement. Outside users who have data interfaces with CPIC are categorized as follows:

- Category 1, police departments;
- Category 2, departments and agencies with some law enforcement roles; and
- Category 3, departments and agencies with limited law enforcement roles.

Category 1 users are the primary users who exchange high volumes of data with CPIC. Data interface between the RCMP and the Federal Bureau of Investigation (FBI) and other law enforcement agencies in the United States is provided through the Automated Canadian United States Police Information Exchange System (ACUPIES).

20.73 The RCMP has identified all data interface partners in its inventory phase for Year 2000. In January 1998, it communicated with all Category 1 users to advise them of its plans and the date when CPIC modules would start using a four-digit year code. It has also communicated with the FBI and both parties have agreed to have their respective systems accept a two-digit and a four-digit year code from January until June 1999, when they expect both systems to be ready.

20.74 However, as of 30 June 1998, the response from Category 1 users had been limited. As a result, the RCMP had little information on whether its plans or time frame are acceptable to those users.

20.75 The prime use of the CPIC system is to provide information to law enforcement personnel on demand. Thus, the ability to continue to exchange data and provide information is of paramount importance. In our view, follow-up with Category 1 users is required and, further, the RCMP needs to extend its communication to users in categories 2 and 3. Subsequent to the audit, the RCMP advised us that it had started to follow up with its Category 1 users and it intended to communicate with users in the other two categories.

20.76 We also noted a Year 2000 project risk associated with the availability of technical resources. The lack of technical resources was a primary cause of the delays noted in paragraph 20.70. We found the resource situation in the application development and the quality control and testing areas to be of particular concern. For example, at the time of the audit only one individual had been identified to conduct testing for the entire CPIC system.

20.77 We have concluded that the CPIC system continues to be at risk. In particular, if end-to-end testing and co-ordination with the user community are not addressed adequately, the use of the CPIC system could be greatly curtailed.

20.78 At the time of our audit, the RCMP was planning to prepare a Year 2000 risk assessment by 31 August 1998 and submit it to the Treasury Board Secretariat. The RCMP has indicated that it has a continuous risk management process in place using outside consultants to assure an independent and objective review, and has made continuous and significant progress. It has also noted that contingency planning is actively under way with a very comprehensive checklist that will be used at every detachment across the country, and that it has played a lead role in educating many police forces and municipalities across Canada on the issue of Year 2000.

Progress Monitoring by Treasury Board Secretariat

20.79 In May 1996, the Treasury Board Secretariat established a project office within its 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 in the government and to address common needs of departments

and agencies. In our 1997 audit, we reported that the Secretariat had helped to raise awareness across the government and had facilitated the exchange of experiences and views on Year 2000 efforts.

20.80 In response to our 1997 recommendations, the Secretariat stated that it had started to examine the state of readiness of all systems that the government considers mission-critical, in order to confirm that they would continue to function properly after 31 December 1999.

Survey results for systems supporting government-wide mission-critical functions

20.81 The project office conducted a survey of 76 departments and agencies in the fall of 1997. It tabulated separately the survey results in the 19 departments responsible for systems that support government-wide mission-critical functions, in 16 other large departments and agencies, and in the remaining 41 smaller departments and agencies.

20.82 In its report of January 1998, the Secretariat noted that although almost all departments and agencies had made significant progress, only a few had carried out substantial repair work or testing of systems by the fall of 1997. It concluded that there was sufficient time to complete the conversion of mission-critical systems but that some non-essential systems might not be converted at the same pace.

20.83 The project office conducted a further survey in the spring of 1998, focussing primarily on the mission-critical functions of the government. Those results were updated in June 1998 and the project office has monitored progress on a monthly basis since then.

20.84 In order to assess progress, the Secretariat used a model from a major information technology research firm. The firm assigns to each of its seven phases of a Year 2000 project an estimate of level of effort required to complete the work. Exhibit 20.8 compares the phases in the generic model we used in 1997 with those in the firm's model; the firm's estimate of level of effort is shown as a percentage.

Exhibit 20.8 is not available, see the Report.

20.85 In the fall of 1997, the research firm considered that an organization should by then have completed 45 percent of its Year 2000 efforts in order to have fully compliant systems in place by 31 December 1999. On that premise, the Secretariat set targets for percentage completion based on elapsed time. According to the targets, departments and agencies should have completed 76 percent of their Year 2000 work by 30 June 1998.

20.86 As of 30 June 1998, however, the Secretariat's summary results showed that overall, the 21 departments and agencies had completed about 50 percent of their Year 2000 efforts for systems that support 46 government-wide mission-critical functions. Two Crown corporations responsible for two such functions were added recently and information on their progress was not available for the June 1998 summary. The results also showed that the pace of Year 2000 action had accelerated in recent months.

20.87 In the spring of 1998, the Secretariat announced that the target date for full implementation of all systems that support mission-critical functions was summer 1999, later confirmed as June 1999 and subsequently endorsed by Treasury Board ministers. Given that this extends the original model by six months, and assuming the same pace of action as seen in the spring of 1998, the Secretariat takes the position that completion by June 1999 is achievable (Exhibit 20.9).

Exhibit 20.9 is not available, see the Report.

20.88 However, in adapting the research firm's model, the Secretariat had set its target using elapsed time as the main proxy for level of effort. Its indicator, percentage completed, did not take into account other measures such as percentage of staff hours used or quantity of work done in comparison with the overall budget. The quantity of work done is often measured in lines of programming code. For some departments and agencies, the Secretariat used the number of lines of programming code as a weighting factor in assessing progress.

20.89 In addition, the model was intended for situations that primarily involved repairing and testing existing systems. The methodology may not be as applicable by departments that have decided as their conversion strategy to replace non-compliant systems. In those cases, progress reporting based on elapsed time may not always be meaningful. In the Secretariat's view, the model is adaptable to situations involving the replacement of systems. However, as of June 1998, it had not adapted the model to that use in assessing the progress of departments and agencies.

20.90 In 1997, we reported that the testing and implementation phase took more effort than all other phases combined. It is now widely acknowledged in the information technology industry that the testing phase of Year 2000 projects generally has proved even more time-consuming than anticipated. Thus, a simple linear projection of percentage completion against a target elapsed time can prove to be optimistic.

20.91 The Secretariat did not validate data and information that it collected in its survey. Although some departments and agencies used internal audit or consultants to validate their Year 2000 progress, others did not. Best practices in industry have Year 2000 project offices seeking independent assurance to validate progress reports that they have received from units in their organizations. Some project offices go to the extent of using automated tools to verify the converted programming codes. Experience in some private sector firms showed that upon validation the reported percentage completed was often found to be overstated.

20.92 We compared our findings on the systems that support the six mission-critical functions we audited with information that the same departments and agencies had provided to the Secretariat. In most cases, the start dates of work and the completion dates that we had noted in the departments were consistent with those in the Secretariat's files. In general, its files did not contain sufficient details to use the number of lines of programming code in support of analysis of quantity of work done and assessment of progress toward making systems Year 2000 compliant.

20.93 While the Secretariat's survey asked for information on data interfaces and embedded systems, these were not used in the calculation of percentage completed. Consequently, the assessments of departments and agencies with significant data dependencies or numerous embedded devices may not adequately reflect their Year 2000 progress.

20.94 We reported last year that 31 December 1998 was emerging as the norm in the information technology industry for full implementation of compliant systems. We are concerned that the Secretariat's target date for full implementation allows only six months to address slippage and unexpected problems. Further, some systems supporting the 48 government-wide mission-critical functions have target dates beyond June 1999 for full implementation. Most of the systems we examined this year have experienced delays, some by up to four months.

Many mission-critical systems remain at risk

20.95 An overall rate of completion for systems supporting government-wide mission-critical functions can provide no more than a general indication of Year 2000 progress. Given that the average rate of completion was 50 percent at 30 June 1998, some departments and agencies were progressing at below that rate.

20.96 According to the Secretariat's summary results at the end of June, 12 departments and agencies responsible for 28 mission-critical functions had a more than 50 percent completion rate for applications, systems and devices

supporting those functions. The Secretariat also noted that information for two departments was not complete and that this could affect their reported percentage completion.

20.97 Overall, the Secretariat's summary of the progress made at 30 June 1998 by the 21 departments and agencies with mission-critical functions was as follows:

- 4 departments and agencies with good progress (over 60 percent complete);
- 10 departments and agencies with satisfactory progress (46 to 60 percent complete); and
- 7 departments and agencies with difficulties (45 percent complete or less).

Progress information on the two newly added Crown corporations was not available in June 1998 and they were not included in the summary results.

20.98 Although the Secretariat's monitoring of progress showed that Year 2000 action in the government had accelerated, as of 30 June 1998 only four departments and agencies, responsible for 7 of the 48 mission-critical functions, were rated as having made good progress; work on 18 functions in nine departments and agencies had a score of 50 percent complete or less.

20.99 We are very concerned that as of 30 June 1998, various of these government systems supporting mission-critical functions remained at risk of not being ready in time.

20.100 In August 1998, the Secretariat advised us that some of its analysts had started attending Year 2000 project meetings in the 21 departments and agencies and the two Crown corporations. In addition, its Year 2000 project director had met with senior staff in some departments to discuss their progress.

20.101 The Secretariat had also written to departments and agencies responsible for systems that support the mission-critical functions to request that risk assessments be completed by 31 August 1998. For systems considered to be at risk of not meeting the implementation target date, detailed contingency plans will be requested by 31 December 1998.

20.102 In our 1997 audit chapter, we recommended that the Secretariat intervene strategically as appropriate to ensure the successful implementation of the government's mission-critical systems. Near the end of this year's audit, although it had held some meetings with certain departments to discuss Year 2000 progress, there were no documented plans to indicate what would trigger intervention, at what dates, and what form it would take.

20.103 Our 1997 chapter also raised the issue of triage, which provides for the redeployment of resources to those systems that are most critical to an organization. While the Secretariat acknowledged last year that triage may become necessary at some point, to date it is not evident what criteria would be used to judge this and how resources could be redeployed among departments and agencies.

20.104 If systems that support mission-critical functions were to remain at risk, it would be essential that contingency plans be developed and tested prior to 2000. Overall, the government's objective for Year 2000 readiness is to ensure that essential programs and services continue for its beneficiaries and stakeholders. The ideal would be fully compliant systems that would support mission-critical functions; interim work-around arrangements may be acceptable for the short term.

20.105 The government should continue to rank Year 2000 as a top priority and further accelerate its efforts on those systems that support its mission-critical functions, to reduce the risk that they may not be fully compliant before 2000.

20.106 The Treasury Board Secretariat should determine when and how it ought to exercise strategic intervention to ensure Year 2000 compliance of systems that support mission-critical functions in government. It should also develop plans for triage and put them in place as necessary.

20.107 Where systems that support mission-critical functions remain at risk, the Secretariat should ensure that contingency plans are developed and tested prior to 2000 so that essential government programs and services continue after 31 December 1999.

20.108 The Secretariat should examine ways to further improve the quality of its survey data and information, including the use of other measures in analyzing and assessing progress and the independent verification of progress information.

Treasury Board Secretariat's response: The Treasury Board Secretariat agrees with and supports the main points of the chapter. The chapter highlights areas of both concern and progress, areas with which we have widely been reported to agree.

We feel that it is critical to note that progress is an ongoing fact during the Year 2000 remediation programs in the departments and agencies we are monitoring. Not only is the percentage of completion (as reported monthly) steadily increasing, but the pace of change is also increasing. In fact, since the audit was completed at the end of June 1998, the overall government readiness has moved from 52 to 64 percent.

We agree with the audit recommendations that the government continue to rank Year 2000 readiness as a top priority. The Treasury Board will continue to receive regular monthly reports on progress. Year 2000 will also be the topic of correspondence from the President of the Treasury Board to his Cabinet colleagues, and from the Secretary to deputy ministers.

The rate of compliance continues to improve; nonetheless, we agree that prudent project management acknowledges the fact that slippage can occur, and triage may have to occur. The Treasury Board Secretariat will be working with departments and agencies in the development of plans for the triage of systems that support government-wide mission-critical functions.

The Secretariat is working with departments and agencies to assist, where possible, in the development or refinement of contingency plans to ensure that government-wide mission-critical functions continue.

The Secretariat does not rely exclusively on elapsed time as an indicator of progress. It is willing to consider changes to improve the quality of reporting, provided that work presently being done on remediation is not jeopardized. We have recommended to departments and agencies the engagement of their own internal audit staff to provide independent verification and validation of the results our analysts collect and report.

Initiatives to Address Common Needs

Some progress made in addressing exposure for Year 2000

20.109 In the 1997 audit, we identified a number of areas in which Year 2000 projects faced significant exposure to risk:

- competing priorities and developments;
- insufficient technical resources;
- failure or delay in obtaining compliant upgrades from vendors;
- data interface exposure; and
- risk of funding delay.

In the audit report, we also noted that there were opportunities for efficiency gains by addressing common issues horizontally. In the current audit, we observed that progress had been made in various areas.

20.110 For example, the Secretariat wrote on several occasions to deputy heads and heads of agencies to emphasize the significance of the Year 2000 threat and the high priority that it ought to be assigned. In March 1998, the government also directed departments and agencies to consider Year 2000 implications in all policy proposals.

20.111 We noted in 1997 that departments were expressing concerns about availability of technical resources; many were experiencing higher than normal attrition rates among computer specialists. Since that time, efforts have been under way to identify and attract information technology professionals into government. The conclusion of contract negotiations with the labour union for the government's computer specialist community has helped to retain staff. In addition, an omnibus contract has been awarded to seven private sector firms to support Year 2000 remediation and testing work on systems that support government-wide mission-critical functions.

20.112 In 1997, the Secretariat estimated the government's total costs for Year 2000 work at \$1 billion. During our 1998 audit, its Year 2000 project office advised us that the cost estimates had been revised to \$1.4 billion. To address the risk of delay in some Year 2000 projects in the event that funds could not be secured on a timely basis, the Secretariat made provisions to make up to a total of \$400 million available for loans to support the departments and agencies responsible for mission-critical functions. As of July 1998, the Secretariat had approved loans totalling about \$365 million to 15 departments and agencies.

Work plan needed for remaining horizontal issues

20.113 While some progress has been made in addressing common needs, exposure remains in the areas we have noted. There is also significant exposure in other areas.

20.114 For example, the availability of technical resources continues to be an area of significant exposure for all Year 2000 projects. Although departments indicate that attrition rates have stabilized since the conclusion of contract negotiations for the government's computer specialists, staff turnover has continued. In examining mission-critical systems, we noted a specific case of slippage for which shortage of technical resources was cited as the reason. Further, the contract for computer specialists in government will expire in 1999, when Year 2000 work will still be critical.

20.115 Data interface also represents an area of significant exposure. Information technology research firms have emphasized the need for end-to-end testing among organizations that interact electronically. In describing its model for comparing Year 2000 progress among organizations, one research firm indicated that such testing would be time-consuming and in some cases difficult to accomplish.

20.116 Legal liability is another area of exposure. In response to our 1997 recommendations, the government assigned a lawyer to co-ordinate its legal efforts. Subsequently, legal co-ordinators were identified in various

departments and agencies. The efforts helped to raise Year 2000 awareness in the government's legal community and resulted in a Year 2000 issue paper. In March 1998, the issue paper was released to departments and agencies to help them in assessing the legal risks to their respective organizations as a result of Year 2000. Nevertheless, given that the government has many regulatory responsibilities, the implications of the Year 2000 threat have yet to be fully analyzed and addressed.

20.117 Embedded systems and devices are emerging as a significant concern. Numbering in the billions, they perform a vast range of duties serving many domains such as science, engineering, manufacturing and health care. Experts have estimated that only a small percentage of these micro processors are date-sensitive. Even so, an estimated 20 million to 250 million could fail as a result of the millennium bug.

20.118 In January 1998, the Treasury Board Secretariat tasked a small team of assistant deputy ministers to review Year 2000 readiness in government. In February 1998, the team reported the issues and areas of exposure we have noted, as well as other impediments to success. It concluded that the Year 2000 challenge could be overcome only if decisions and actions were taken to address the issues it had identified.

20.119 As of August 1998, the Secretariat had started to define broad roles for some departments and agencies to address a number of those issues. In early October we were advised by the Secretariat that it had identified two initiatives to assist departments and agencies in dealing with embedded technology, and that it planned to hold a symposium on embedded devices and technology later that month. The Secretariat indicated that the initiatives would proceed once funding became available. However, a work plan that includes the following has yet to be developed:

- a full list of the issues to be addressed;
- roles and responsibilities of each organization assigned to address them;
- the resources required;
- the desired deliverables; and
- a time frame for their completion.

As we reported in 1997, if the issues are not pursued expeditiously, the potential benefits of the horizontal effort to help departments and agencies overcome the Year 2000 threat will not be fully realized.

20.120 The Treasury Board Secretariat should develop a work plan and take steps to facilitate the resolution of common horizontal issues that departments and agencies face in addressing Year 2000.

Treasury Board Secretariat's response: Plans and efforts have been put into place for monitoring and assessing departmental readiness, and identifying horizontal readiness issues through interdepartmental working groups and other means. With the need for a more frequent and detailed reporting schedule to Treasury Board ministers, and for addressing overall issues related to government readiness, Treasury Board Secretariat agrees that additional and more precise plans must be prepared. A master plan for reporting to ministers has already been completed and the integrating of additional activities is under way.

Reporting Information to Ministers and Parliament

Information on Year 2000 urgency and progress has been provided to ministers

20.121 In 1997, we recommended that departments and agencies work to engage the involvement and concern of ministers and advise them of the urgency of the Year 2000 threat. We also recommended that the Secretariat advise the Treasury Board periodically of the government's progress. In addition, we recommended that Parliament be kept informed about the potential impact of Year 2000 on the government and about the government's progress in making its systems compliant.

20.122 We found, in this audit, that the government has kept ministers informed about the priority and significance of Year 2000. Further, since our 1997 audit the Secretariat has appeared several times before the Treasury Board to discuss the Year 2000 issue and provide information on the government's progress, and to seek approval for specific measures and related funding as necessary. As we neared the completion of our audit work in 1998, the Secretariat advised us that it would be providing Treasury Board with monthly updates of Year 2000 progress.

Information to Parliament needs to be improved

20.123 Subsequent to the tabling of our October 1997 Report to Parliament, two standing committees of the House of Commons held hearings on the subject of Year 2000. The Standing Committee on Industry studied industry readiness; the Standing Committee on Public Accounts focussed on Chapter 12 of our Report, on the government's preparedness for Year 2000. The Chief Information Officer of the Treasury Board Secretariat appeared as a witness at hearings of both committees.

20.124 In November 1997 the Public Accounts Committee tabled its Second Report to the House of Commons, on Chapter 12 of our Report. It recommended, among other things, that the Treasury Board Secretariat prepare semi-annual reports on Year 2000 progress and submit them to the Committee, commencing January 1998.

20.125 The government accepted the recommendations and the Secretariat submitted its first progress report to the Committee in early February 1998. The progress report was dated January 1998 and reflected status as of the fall of 1997. As of 31 August 1998, no further progress reports had been submitted. Consequently, the information that the Public Accounts Committee had on Year 2000 progress was almost one year out of date. The Secretariat has since advised us that in late September 1998 it submitted a second progress report to the Committee.

20.126 Although the Committee also recommended that information on departments' Year 2000 progress be included in their Performance Reports, we found no evidence that the Secretariat had communicated this to departments. Four departments and agencies that we audited this year referred to Year 2000 in their 1998-99 Estimates documents and only one department reported on the status of its Year 2000 project in its 1997 Performance Report to Parliament.

20.127 **The government should improve its reporting of information to Parliament on its progress in making systems compliant for Year 2000.**

Treasury Board Secretariat's response: Treasury Board Secretariat has reported to the Public Accounts Committee, the Industry Committee, and to Cabinet. We will continue to examine ways of keeping Parliament informed.

Conclusion

20.128 One year after our 1997 audit, we found that the government has given the Year 2000 threat a high priority and accelerated the pace of its work on Year 2000 projects. Progress has also been made in monitoring Year 2000 work on government-wide mission-critical functions and in addressing certain common issues that affect many departments and agencies.

20.129 However, in reviewing the June 1998 survey results summarized by the Treasury Board Secretariat, we observed that only four departments responsible for 7 of the 48 mission-critical functions in the government were rated as having made good progress; nine departments and agencies responsible for 18 mission-critical functions had a score for work completed of 50 percent or less. The results of our examination also showed that, as of June 1998, several key systems supporting three of six government-wide mission-critical functions remained exposed to the Year 2000 threat.

20.130 We have concluded that with 18 months left, many systems that support mission-critical functions remain at risk of not being ready before 2000. We are very concerned that some essential government services could be interrupted at the start of 2000.

20.131 Notwithstanding the accelerated pace of work and the progress made since our last audit, more needs to be done. There needs to be a continued focus on Year 2000, including strategic intervention by the Treasury Board Secretariat as appropriate, and preparation and testing of contingency plans by departments and agencies to ensure that those mission-critical functions continue without interruption into 2000.

20.132 As we reported in 1997, other areas remain exposed to risk and merit common, horizontal efforts to address them. Reporting of information to Parliament on Year 2000 issues needs to be improved.

About the Audit

Objective and Scope

The 1998 audit focussed on selected government-wide mission-critical functions and selected systems that support them. Our objective was to assess the progress the government has made in identifying and mitigating the risks to its systems that support mission-critical functions as a result of the millennium date code problem, and to report on this to Parliament.

We examined actions taken by the government to address our October 1997 Report recommendations. We obtained an update of the government's state of readiness for Year 2000 at 30 June 1998 by reviewing survey results collected by the Treasury Board Secretariat. We have not audited the representations made by departments and agencies in the surveys.

In addition, we assessed Year 2000 risks to certain systems and applications that support six mission-critical functions of the government. The functions were selected on the basis of their significance to health and safety, to financial and legal implications and to essential services and support for program beneficiaries. Those systems and applications operate in the following departments and agencies:

- Canadian Food Inspection Agency;
- National Defence;
- Human Resources Development Canada;
- Indian and Northern Affairs Canada;
- Revenue Canada; and
- Royal Canadian Mounted Police.

The departments of National Defence, Human Resources Development Canada and Revenue Canada were among the nine departments that we audited in 1997.

Our findings pertain only to the systems and applications that we examined and are not representative of general progress in those departments and agencies.

Criteria

The general criteria used in this audit followed those used in our 1997 audit of the government's overall state of Year 2000 preparedness:

- There should be ongoing leadership initiatives to sustain commitment and support from departmental and/or agency senior management.
- Systems and applications that are critical to government as a whole should be identified, and the progress of their Year 2000 conversion, testing and implementation should be monitored and reported periodically. Where necessary, strategic intervention should be exercised to ensure that these systems and applications are successfully implemented before 2000.
- Where risk of failure remains a threat to critical functions of government, contingency plans should be

developed and measures put in place to provide for appropriate transition to 2000.

- Initiatives should be in place to co-ordinate and facilitate Year 2000 efforts of departments and agencies to maximize their cost effectiveness.
- Parliament should be kept informed of matters of significance arising from the Year 2000 challenge and its effects on government programs and service delivery, including the government's progress in making its systems Year 2000 compliant.

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Chapter 21

Canadian International Development Agency

Geographic Programs

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Canadian International Development Agency

Geographic Programs

Main Points

21.1 In our 1993 Report, we raised a number of concerns about the performance of CIDA's Bilateral Programs. Our 1995 and 1996 Reports contained a description of CIDA's actions to implement an ambitious program of change and renewal. In this chapter we report on the extent to which CIDA has resolved the main concerns we raised in 1993.

21.2 CIDA has adopted the concept of results-based management to change the Agency into a more results-oriented and learning organization. Progress is evident. CIDA has introduced a Results-Based Management Policy Statement, and supporting policies and guidelines have been developed and communicated to staff. It has established a Framework of Results and Key Success Factors as a guide for its managers and partners to focus more on results as they manage projects. However, progress in applying the principles of results-based management to CIDA contracts has been slow.

21.3 CIDA is in the process of developing, reviewing and updating Regional/Country Development Policy Frameworks for all major countries and regions. Some of the more recently developed Frameworks state objectives and expected results. However, the expected results are not compared with actual results, one of the key means of assessing performance.

21.4 At the project level, where official development assistance (ODA) is actually delivered, we found a greater emphasis on results, but uneven progress toward actually managing for results. Critical assumptions for project success and expected results have been articulated and a system of annual progress reporting implemented, but the statements of expected results are not always realistic. Further, once critical risks have been identified and assessed, they are not consistently monitored and addressed. This calls into question whether the expected benefits of projects will be realized. Projects are not systematically monitored after funding ends to determine whether the results expected have been achieved.

21.5 CIDA prepares internal reports on performance, reflecting its increased ability to assess and report systematically on its performance. It also submits an annual Performance Report to Parliament; this would be improved if CIDA showed progress toward results for individual projects in the context of the results expected. In reviewing the Performance Report, we concluded that more rigour is needed to ensure that information is clear, meaningful, and accurate. The delivery of ODA in a great many countries and under uncertain political and economic conditions is a very complex and challenging undertaking, one that results in varying degrees of success. We believe it is important that CIDA bring out this dimension in its reporting; a more balanced picture would enhance the credibility of its reports.

21.6 We concluded that CIDA's actions have addressed the main concerns raised in 1993. The Agency now needs to keep up its momentum in implementing management for results. It has much of the supporting framework in place. To close the accountability loop, it needs to continue working on the measurement and reporting of development results.

Introduction

21.7 CIDA is responsible for administering about 78 percent of Canada's International Assistance Envelope (IAE). The remainder is delivered by, among others, the Department of Finance, the Department of Foreign Affairs and International Trade and the International Development Research Centre.

21.8 CIDA delivers its international assistance through a variety of channels. Geographic programs, also referred to as bilateral or country-to-country programs, account for nearly half of its program expenditures. The rest is delivered through funding to multilateral institutions such as United Nations programs, to international financial institutions such as the Regional Development Banks, and to a multitude of non-governmental organizations including universities, businesses and not-for-profit organizations.

21.9 As a result of Program Review, Canada's budget for international assistance was cut from \$2.6 billion in 1994-95 to \$2.1 billion in 1997-98; CIDA expenditures for Official Development Assistance (ODA) within this envelope were reduced from \$2.2 billion in 1994-95 to \$1.7 billion in 1995-96 and have remained relatively constant since then (see Exhibit 21.1). In April 1995, the government transferred the management of the program for Central and Eastern Europe and the Newly Independent States from the Department of Foreign Affairs and International Trade to CIDA. Although the program does not fall within the ambit of Canada's ODA, it is intended to be consistent with the foreign policy's six priorities of official development assistance.

Exhibit 21.1 is not available, see the Report.

21.10 For 1998-99, the IAE budget is about \$2 billion; \$1.6 billion of this will be spent on CIDA programs. Bilateral programs (Geographic Programs and Bilateral Food Aid) account for approximately \$790 million, or about 50 percent of the Agency's total expenditures (see Exhibit 21.2).

Exhibit 21.2 is not available, see the Report.

Focus of the audit

21.11 This audit was the third and final phase of a planned follow-up. Phase I consisted of two parts: first, the Agency's self-assessment of the actions taken as part of its renewal to address the principal concerns raised in our 1993 Report; and second, its development of a Performance Measurement Model (now called the Bilateral Project Performance Review System). Phase II covered CIDA's progress in implementing the model to measure and report on the performance of its bilateral programs and projects. This audit was Phase III and followed through on our 1993 work. Details on how we approached this work are presented at the end of the chapter in **About the Audit**.

21.12 Because ODA is delivered through projects, our audit was focussed primarily at the project level. We reviewed the Agency's programming framework in the countries selected for audit and its linkage with projects in those countries. We examined 28 projects in five countries, paying particular attention to planning, managing for, measuring and reporting results. In the course of our work, we heard many favourable comments by CIDA's country partners about the dedication and co-operation shown by CIDA staff. Our country-specific findings are presented on pages 21-18 to 21-22.

Observations and Recommendations

Resolving Conflicts Among Objectives

Aid is tied more closely to foreign policy objectives

21.13 In 1993, we were concerned that it was difficult for CIDA to concentrate on its objective of putting poverty first and encouraging self-reliance while, at the same time, it had commercial and political objectives that did not always lend themselves to dealing with poverty in a direct way and that encouraged external dependency.

21.14 We felt that competing or conflicting objectives should be pursued only consciously and in full realization of the impact on the primary objectives. At stake was CIDA's ability to pursue its development mandate effectively.

21.15 In 1995, the government released its foreign policy statement *Canada in the World*, which set out a new mandate for Canada's Official Development Assistance (ODA), and defined international assistance as an integral instrument of foreign policy:

The purpose of Canada's ODA is to support sustainable development in developing countries in order to reduce poverty and to contribute to a more secure, equitable and prosperous world.

21.16 *Canada in the World* mandates Canada's ODA to concentrate available resources on six program priorities: Basic Human Needs; Women in Development; Infrastructure Services; Human Rights, Democracy and Good Governance; Private Sector Development; and Environment.

21.17 *Canada in the World* helped CIDA to address problems of conflicting objectives. It led to a policy framework that provides a structure for linking CIDA's development efforts to Canada's foreign policy more rationally than had been the case under the previous strategy. Further, it has helped CIDA to communicate and explain its work to its partners and stakeholders.

21.18 CIDA budgets its bilateral ODA on a country basis. The need to concentrate assistance efforts on a limited number of countries has been a long-standing issue. In *Canada in the World*, the government committed itself to doing so while maintaining programs in other countries through low-cost, administratively simple delivery mechanisms. Over 120 countries received Official Development Assistance from Canada in 1996-97; the 20 largest beneficiaries accounted for just under 63 percent of the total amount. This represents an increase from 1993-94, when the 20 largest beneficiaries received 58 percent. As shown in Exhibit 21.3, the amount of assistance provided to countries rated by the Organization for Economic Co-operation and Development (OECD) as "least developed" and "other low income" has remained constant at about \$458 million, or 55 percent of CIDA's ODA expenditures.

Exhibit 21.3 is not available, see the Report.

21.19 *Canada in the World* calls for 25 percent of ODA to be committed to the program priority of Basic Human Needs, which includes emergency humanitarian assistance. In 1996-97, 38.4 percent of CIDA's ODA program expenditures went to Basic Human Needs, including food aid and humanitarian assistance (33.9 percent when emergency humanitarian aid is excluded).

Implementing Results–Based Management

Progress toward results–based management is evident

21.20 As a result of its 1992 Strategic Management Review and our 1993 report on its bilateral programs, CIDA launched an ambitious renewal initiative in 1994. It made a commitment to Parliament to transform the Agency into a more results–oriented, accountable organization. CIDA adopted a policy of results–based management as an Agency–wide initiative to enable it to systematically address these commitments (see Exhibit 21.4).

Exhibit 21.4

CIDA’s Results–Based Management Policy Statement

Results–based management in CIDA means:

- defining realistic expected results, based on appropriate analyses;
- clearly identifying program beneficiaries and designing programs to meet their needs;
- monitoring progress toward results, and resources consumed, with the use of appropriate indicators;
- identifying and managing risks, while bearing in mind expected results and the necessary resources;
- increasing knowledge by lessons learned, and integrating them into decisions; and
- reporting on results achieved and the resources involved.

The Policy defines the results chain for bilateral program and project as follows:

- output is the immediate, visible, concrete and tangible consequence of program/project inputs;
- outcome is the result at the purpose level, constituting the short–term effect of the program/project;
- impact is a broader, higher–level, long–term effect or consequence linked to the goal or vision.

21.21 To make the policy operational and to integrate the concept of results–based management into project delivery, the Agency undertook several key steps:

- developed an Agency Accountability Framework;
- assembled practices, policies and guidelines into a Roadmap for practitioners;
- articulated its Framework of Results and Key Success Factors;
- developed Regional/Country Development Policy Frameworks; and
- provided extensive training.

These and other actions represent significant advances by the Agency in putting into place the supporting framework for implementing results–based management.

An accountability framework has been developed

21.22 In 1993 we highlighted a need to clarify the extent to which CIDA is accountable to Parliament for managing for results, and the extent to which CIDA’s staff and its partners are respectively accountable for obtaining results. In July 1998, CIDA’s executive committee approved an accountability framework. It identifies accountabilities of the Agency overall; it further articulates the accountabilities of the President, branch heads, and key managers in each branch.

21.23 The basic definition of accountability in the framework requires that CIDA identify its objectives and demonstrate that the resources allocated to it for official development purposes are managed to achieve the intended results. It also requires that the Agency report the results achieved in its development programs to Parliament and the Canadian public. The framework indicates that, through its partnerships with developing countries and Canadian and international partners, CIDA shares accountability for development results and its own accountability must be viewed in that light. CIDA accepts responsibility and accountability for monitoring actions by its recipient partners as well as other events that may affect development goals, and for acting to ensure that momentum toward these goals is maintained.

21.24 This shared accountability for ODA delivery makes it especially important for CIDA to follow through on its programs and projects so it can be in a position to report on whether Canada's ODA is producing the expected results. This type of information would be useful to include in CIDA's Performance Report to Parliament.

21.25 CIDA accepts that it is fully accountable for achieving operational results. This means that it is fully accountable for the setting of objectives, formulation of policies, selection of development initiatives, allocation of resources, monitoring and performance reporting. This also involves identifying expected outputs and outcomes, assessing related risks and monitoring them, and taking appropriate corrective action.

Work on results-based contracting has slowed considerably

21.26 The Agency has not been as successful in its attempt to develop results-based contracting. CIDA delivers nearly all bilateral ODA through contracts with Canadian executing agents (CEAs). In 1995, it recognized the need for a contracting approach that would define the respective accountabilities and risks of both the executing agents and CIDA. In 1996, CIDA consulted with its CEA community. A joint task force, representing CIDA and the community, defined results-based contracting as "a contracting method which employs an iterative and participatory approach to results definition and seeks to promote the achievement of development results through appropriate contractual terms such as the statement of work, the basis of payment (including incentives) and mutually accepted performance indicators."

21.27 The report by the task force in June 1996 expressed some concerns about this approach; to address them it articulated a number of guiding principles. It called on the Agency and the supplier community to use the ideas and suggestions in the report and further develop the necessary policies, programs and operational practices needed to implement results-based contracting. However, CIDA deemed them too impractical to implement. Since then, progress has slowed considerably. The Agency told us that the complexity of trying to develop a results-based contracting approach was much greater than expected. In July 1998, a committee chaired by the President was established to review and simplify CIDA's contracting regime. Part of its work will be to recommend changes needed to implement an approach to contracting for results.

21.28 **CIDA should make every effort to identify practical steps that it can take to incorporate the principles of results-based management in its contracts, and experiment with these steps in selected projects.**

CIDA's response: CIDA will continue to follow the course of action developed by the Committee for Improving Contracting. Based on the results of pilot projects, it will pursue a practical and iterative approach to contracting for results and apply the lessons learned, where feasible, to its contracting process, recognizing that this is a long-term endeavour.

Risk management and monitoring need to be more consistently integrated into projects

21.29 Our 1993 audit of CIDA's bilateral programs noted the need for improvements in the way CIDA manages its operating risks, and CIDA then took steps to improve its risk management. Project managers were expected to monitor anticipated risks and use the information thus gathered to adjust project activities as necessary. CIDA's

Results-Based Management Policy Statement and its Framework of Results and Key Success Factors called risk management integral to results-based management at the level of both country and project. We found that CIDA has improved its guidance and training on the identification and assessment of risk. Managers are trained to include in approval documents critical assumptions about risks to the outputs, outcomes and ultimate impacts of projects. However, there is little practical guidance on how to collect and use information on project risks, except for financial risk, as these evolve over time. CIDA would benefit from developing more specific guidance and tools in this area.

21.30 Our 1993 audit underlined the need to be able to obtain early warnings of project difficulties. In most of the projects we examined, we found limited ongoing monitoring of risks that had been identified in the planning phase, and no deliberate strategy for managing them. In their project reports to CIDA headquarters, Canadian executing agents normally discussed activities, not risks. In a number of projects, problems arose that had been at least partially predicted through risk analysis in the planning phase.

21.31 CIDA guidance and training have so far dealt with external risks — those outside the direct control of project managers, and often related to the level of commitment by the recipient country. The guidance does not address the equally important job of managing risks that are more internal to the project — for instance, those related to critical tasks, key personnel, or project complexity.

21.32 CIDA should broaden its guidance on risk assessment and risk management to include internal risks as well as external risks to a project.

CIDA's response: CIDA will strengthen its identification, assessment and management of internal risks of projects by enhancing the guidelines in the bilateral Roadmap and by reinforcing risk management in its training on results-based management.

Determining whether benefits have endured is essential

21.33 In order for development to occur, the benefits from a project should last beyond the termination of aid funding. The sustainability of benefits needs to be considered throughout the duration of CIDA's involvement, and monitored afterward to determine whether expected benefits have endured. Exhibit 21.5 lists four key indicators of project self-sustainability. We noted that when events put at risk these conditions for sustainability, reactions by project managers were inconsistent. Some took action to deal directly with the risk. Others tended to continue the project with minor adjustments or consider applying additional resources, rather than stand back and analyze more fundamentally whether the project should be substantially changed or discontinued.

Exhibit 21.5

Four Key Indicators of Project Self-Sustainability

Technical and managerial capability or readiness of the recipients (recipient country or "inheritor" institution) to sustain the project.

Commitment of the "inheritor" to assume ownership and responsibility for sustaining the project.

Target group involvement in project design and evaluation, and the value it places on the development benefits.

Availability of sustaining resources — cash and other resources — to operate and maintain the project over its life cycle.

21.34 Generally, sustainable programming requires commitment to projects over a long time frame — possibly 10 to 15 years. The commitment must be supported by a strategy addressing the level of programming that is appropriate, the participation of other donors, and the recipient country's capacity to assume the project activities fully once CIDA's funding ends. We found that CIDA's five-year planning horizon does not cover the period of

time that can be expected to elapse before the outcomes of these longer-term projects begin to take effect. Consequently, some of the projects cannot be sustainable unless their initial phases, usually five years, are extended by another one or two phases; yet planning documents do not always reflect this consideration.

21.35 CIDA and other donors are leaning increasingly toward “softer” projects, such as the institution-strengthening and capacity-building projects we examined. Because managing and measuring results achieved from these projects present a new set of challenges, and the projects are related indirectly to poverty reduction, CIDA needs to closely monitor its own experience and that of others to ensure that this type of program tool is producing the expected results.

21.36 Applying results-based management to this softer type of project is particularly challenging. For example, expected results of development are hard to define and perhaps even harder to measure in projects that involve institution strengthening and capacity building. In most cases, longer-term outcomes and impacts of development do not begin to show until years after CIDA’s direct involvement in funding ends.

21.37 To focus on results, however, CIDA needs to monitor whether the expected shorter-term effects of a project have been achieved and are likely to lead to the desired longer-term development impacts. Even though a project may be finished and CIDA funding ended, it is still important to monitor in a cost-effective way whether the expected results have materialized. We found that CIDA does not systematically continue to monitor projects after their completion to determine whether the results expected in the short and long terms have been achieved. Lack of this information precludes both possible action to increase the prospects of long-term results and an opportunity to learn lessons for future projects. Currently, CIDA obtains this kind of information in a limited way only through periodic performance reviews of its development priorities.

Reporting on Project Performance

The quality of performance reporting is inconsistent

21.38 Although the elements of results-based management are becoming embedded in project delivery, the first key step — defining results that are realistic — has not been easy. In most of the projects we examined, the initial statements of expected results — particularly long-term impacts — were unrealistic, resulting in a subsequent need to modify the project or its goals, and presenting problems for reporting against expected results.

21.39 Results-based management guidelines and policies issued in 1996 refer frequently to expected results, and to comparing them with actual results. In practice, however, the focus has been on the immediate or short-term results of projects. Although statements of expected impacts or longer-term effects are developed along with quantitative or qualitative indicators of them, they are not integrated into the project management system for aid delivery. For example, there is no provision for longer-term monitoring to assess these indicators and report on whether development goals have been achieved.

21.40 The Policy for Performance Review, the Results-Based Management Policy Statement, and the accountability framework provide the structure for CIDA’s performance measurement and reporting systems. The Annual Project Progress Report system (APPR), begun in 1996, provides the basic tool for tracking active projects with a value over \$100,000.

21.41 Once project managers complete these progress reports, branch management reviews them, and uses them to track the results of the projects. They are also used at the country and branch levels to address the difficulties identified in them. The information in the APPR includes project expenditures, expected and actual results (outputs, outcomes and impacts), lessons learned and progress ratings. The individual reports are compiled and a Bilateral Branch Achievement Report is produced. These reports along with audit and evaluation reports are used as inputs to prepare the Agency’s Performance Report to Parliament.

21.42 We reviewed the 1997-98 APPRs on the projects we had selected for our audit to see whether, based on our understanding of the projects, the information provided was accurate and meaningful. We found that most of the reports reflected the status of the projects fairly. However, in some APPRs we noted that the information was stated in terms that were more positive than the situation warranted. Also, actual results could not always be readily compared with the statements of intended immediate and short-term results. The Annual Project Progress Report system is still evolving. More management attention is needed, in our view, to ensure that the information provided in the reports is accurate and meaningful and that it is used in deciding on the future direction of projects.

CIDA's Performance Report to Parliament

More meaningful, accurate and balanced reporting is needed

21.43 Along with other government departments, CIDA submitted its 1996-97 Performance Report to Parliament in the fall of 1997. To determine how its performance reporting system works in practice, we reviewed the way CIDA produced the Geographic Programs section of its Performance Report for the fiscal year ended 31 March 1997. The Annual Project Progress Reports (APPRs) are the main source of the project information presented in the Performance Report; the latter cites many examples of the results produced by CIDA projects. We compared the results of 33 illustrations shown in the section on Geographic Programs with the results shown in the APPRs for the same projects.

21.44 The Performance Report describes a number of projects to illustrate performance. The Agency points out that international development activity does not yield meaningful results in neat financial year intervals. Consequently, most of the illustrations present the results of activities that span a number of years, but the distinction is rarely made between these results and others that were the result of only one year's activity. Where the results shown cover several years of activity, the number of years is not shown. No information is given on the resources used to achieve the results shown for specific projects. These resources may include not only CIDA's expenditures but also the human and financial resources provided by other donors and recipient governments. Also, while the illustrations describe achievements, they do not describe them in the context of the results that were expected. Nor do they describe the significance of these specific projects in the context of the overall development program for the country. This information would provide a more meaningful picture of the Geographic Program's performance.

21.45 We also noted instances where the stated results were not consistent with those in the Annual Project Performance Reports (APPRs). These included, for example, showing expected rather than actual results or results beyond those shown in the performance reports. In our view, more rigour is needed in reviewing and compiling information for the Performance Report to ensure that it is clear and accurate.

21.46 CIDA delivers ODA in many countries under uncertain political and economic conditions and enormous constraints of infrastructure and geography. This makes project success and assessment of development results very complex and challenging. We noted that the branch achievement reports include numbers and percentages of projects that are progressing satisfactorily, those that have manageable problems and those with serious problems. However, the 1996-97 Performance Report excludes this information, although the Agency has reported it in the past. We believe it is important that CIDA bring out this dimension in its reporting; the credibility of its reports would be enhanced by a more accurate balance between positive accomplishments and areas where expected results could not be achieved. In the latter cases, CIDA could describe the types of actions it has taken to deal with problems or the way it will apply lessons learned to future projects.

21.47 **CIDA should more rigorously review the quality of the information in its Performance Report, and present a more meaningful and balanced picture of its performance.**

CIDA's response: CIDA will continue to improve the consistency, accuracy and reliability of its performance information so that a more balanced and meaningful picture can be reflected in its Performance Reports.

Core indicators to measure development progress are being developed

21.48 In its Performance Report, CIDA acknowledged that it is possible to measure outputs (the immediate, visible, concrete and tangible results of a project) and outcomes (the achievement of the purpose identified for the particular project). However, it questioned the feasibility of using aggregated performance information from the project and institutional levels to comment definitively on the Agency's overall performance or on its performance at the country or program level.

21.49 The Agency points to the difficulty of measuring impacts — that is, broader, higher-level, long-term benefits to the community, country or group. There are several factors that make the task highly problematic. A key one is the difficulty of attributing a particular development impact to a specific CIDA contribution. A second is delay: generally, outcomes and impacts can be expected only several years after projects have been completed. It is difficult to track them after the beneficiaries have taken ownership of a project. CIDA points out that other donors also experience these difficulties. The Agency is sharing with them its approaches and its performance data to find ways of addressing these concerns.

21.50 We agree that it may be difficult to measure outcomes and impacts and to attribute them to a single project or a single donor such as CIDA. Nonetheless, the Agency allocates bilateral program funds on a country or regional basis. The strategic planning process culminates in a multi-year plan at the country or regional level, based on an analysis of the various factors and risks underlying CIDA's interventions. We noted that some of the more recent Regional/Country Development Program Frameworks state the development results that are expected at the country level. CIDA could attempt to periodically assess whether these expected results have been achieved at the regional/country level.

21.51 Reporting on Canada's ODA program is often done in terms of amount spent — usually as a percentage of Gross National Product (GNP), which is then compared with the standard international spending target for ODA, 0.7 percent of GNP. In 1996-97, Canada's spending on ODA was about 0.34 percent of GNP. This indicator is widely used internationally for intercountry comparisons of spending on official development assistance.

21.52 While this may be a useful indicator of spending on aid effort or commitment to it, it is an indicator of input rather than output: it does not measure the results or the effectiveness of aid. Developing indicators of results is a logical next step in CIDA's results-based management process. CIDA has been supporting and working with the Development Assistance Committee of the OECD to develop a working set of core indicators for measuring the progress of development efforts. An illustration of these possible indicators is shown in Exhibit 21.6. Developing and reaching international consensus on core indicators of results is a complex undertaking, and the current effort is still very much a work in progress. We encourage CIDA to keep up its efforts with other donors, multilateral institutions and developing countries to refine and reach consensus on a set of indicators.

Exhibit 21.6

Measuring Development Progress: A Working Set of Core Indicators

Goals		Indicators
Economic Well-Being		
Reducing extreme poverty	The proportion of people living in extreme poverty in developing countries should be reduced by at least one-half by 2015.	<ol style="list-style-type: none"> 1. Incidence of extreme poverty: population below \$1 per day. 2. Poverty gap ratio: incidence times depth of poverty 3. Inequality: poorest fifth's share of national

		consumption 4. Child malnutrition: prevalence of underweight under 5s
Social Development		
Universal primary education	There should be universal primary education in all countries by 2015.	5. Net enrolment in primary education 6. Completion of 4 th grade of primary education 7. Literacy rate of 15 to 24 year-olds
Gender equality	Progress towards gender equality and the empowerment of women should be demonstrated by eliminating gender disparity in primary and secondary education by 2005.	8. Ratio of girls to boys in primary and secondary education 9. Ratio of literate females to males (15 to 24 year-olds)
Infant and child mortality	The death rates for infants and children under the age of five years should be reduced in each developing country by two-thirds the 1990 level by 2015.	10. Infant mortality rate 11. Under 5 mortality rate
Maternal mortality	The rate of maternal mortality should be reduced by three-fourths between 1990 and 2015.	12. Maternal mortality ratio 13. Births attended by skilled health personnel
Reproductive health	Access should be available through the primary health-care system to reproductive health services for all individuals of appropriate ages, no later than the year 2015.	14. Contraceptive prevalence rate 15. HIV prevalence in 15 to 24 year-old pregnant women
Environmental Sustainability and Regeneration		
Environment	There should be a current national strategy for sustainable development, in the process of implementation, in every country by 2005, so as to ensure that current trends in the loss of environmental resources are effectively reversed at both global and national levels by 2015.	16. Countries with national sustainable development strategies 17. Population with access to safe water 18. Intensity of freshwater use 19. Biodiversity: land area protected 20. Energy efficiency: GDP per unit of energy use 21. Carbon dioxide emissions
General Indicators		
Other selected indicators of development	Population Gross National Product	GNP per Capita Adult Literacy Rate GNP Total Fertility Rate Life Expectancy at Birth Aid as % of GNP External Debt as % of Investment as % of GNP Trade as % of GNP

Source: OECD

21.53 Once this is done, CIDA could use the indicators in its reports to describe a country's development results. Because donors are acting more in concert, the results will likely not be attributable directly to any one donor, but CIDA could show how its projects have contributed to the overall results. What is important is that lasting development results be achieved, not that they be attributed directly to the intervention of any particular donor. This type of reporting would reinforce CIDA's move to focus more on development results, and would improve accountability for the effective use of ODA funds.

Counterpart Funds

CIDA has responded to 1993 concerns but better control is needed over payments into counterpart funds

21.54 In June 1994, CIDA published a set of new directives on counterpart funds. The new directives defined the respective accountabilities and responsibilities of CIDA and the recipient country for managing counterpart funds. Counterpart funds are a development instrument whereby Canadian commodities or goods are converted to aid funding. CIDA approves a project amount, which it refers to internally as a line of credit to the recipient country, to finance the purchase of the commodities or goods in accordance with its Canadian content policy. A Canadian supplier sells the product in the recipient country and CIDA pays the supplier in hard currency. The policy requires that normally the same amount in local currency then be paid into the counterpart fund by the local buyer as described in the agreement with the recipient country. The counterpart fund legally belongs to the recipient country; it is usually controlled by a joint board and used to fund development activities. In 1993, we were concerned about CIDA's lack of assurance that all moneys in counterpart funds had been spent for the intended purposes and had been accounted for fully.

21.55 In 1997, CIDA undertook an audit of counterpart funds. An interim audit report in March 1998, based on the audit of three funds, noted weaknesses in the flow of money into all three that had resulted in the appropriate amounts not being credited to the funds. In one case, the internal audit could not provide assurance that the recipient government had deposited into the fund the full amount that was required, and that funds had been used for the purposes intended. The audit also concluded that CIDA should re-examine the issue of the ownership of the funds as well as reporting on results achieved from their use. As a result, the counterpart fund policy is being revised to address these concerns.

21.56 We examined three counterpart funds in Bolivia, Bangladesh, and Senegal. Given that the structure of each counterpart fund is unique to the country in which it operates, we cannot form an opinion on the management of counterpart funds in general. We found that for the funds we examined, CIDA had adequate assurance that all moneys had been spent for development purposes and had been accounted for fully. However, in two of the funds we found problems in control over the flow of moneys that resulted in less than the full amounts being placed in the funds. In one case, CIDA allowed payment into the fund of less than it had paid to the Canadian supplier (see Exhibit 21.7). In the other fund, the memorandum of understanding with the recipient country allowed it to withhold from the amount to be deposited up to 7.5 percent in incidental charges. We noted that there had been no study, as called for by CIDA policy, to establish the amount of the net proceeds to be placed in the fund; the recipient country consistently withheld the full 7.5 percent. There was no accounting for how these funds had been spent, as we would have expected in the absence of such a study. Over the last three years, these charges averaged \$930,000 per year. Given the potential for problems of this nature, CIDA will need to ensure that it applies its policy on payments to counterpart funds more consistently.

Exhibit 21.7

Problems in Control Over the Flow of Money Into a Counterpart Fund

The counterpart fund in Senegal involved the sale of Canadian sulphur. There is a world market for sulphur. We found in at least three shipments that the buyer in Senegal would not agree to pay the price per ton that the Canadian supplier had quoted, insisting instead on paying no more than the going international price. CIDA financed the transactions at the higher price, and allowed the buyer to deposit the lower amount to the counterpart fund. As a result, in the three transactions CIDA paid Canadian suppliers a total of US \$844,000 above market rates in order to maintain the viability of the counterpart fund. This was contrary to the intent of CIDA policy and to the agreement with the recipient country.

In answer to a letter from a Canadian supplier complaining about the bidding procedures for this project, CIDA's President responded in August 1993:

... In the case of CIDA's lines of credit with recipient countries, the final decision to contract always rests with the buyer who is

required to reimburse his government an equivalent value in local currency to that paid by CIDA to the supplier in Canada. If the buyer does not agree with the price, he/she simply refuses to enter into contract and the tender is cancelled....

We did not find appropriate written authority for CIDA to act contrary to these principles. Officials told us that there were no alternative products to provide funding for the counterpart fund had the sales not gone through. As this fund was necessary to pay for the Senegalese portion of many of CIDA's projects in that country, lack of funds would have jeopardized nearly all those projects. This was recognized by CIDA and we were informed that corrective action is being taken. No substantiated explanation was on file for the higher-than-world-market prices quoted by Canadian firms.

Bangladesh

Bangladesh is one of the Agency's largest bilateral programs. In 1997-98, CIDA's expenditures on the program were \$37 million; over the past five years they have totalled about \$225 million.

In 1991, CIDA developed a Country Development Policy Framework for Bangladesh. The framework pointed to many structural weaknesses in the country, such as weak state institutions and a lack of local financial resources to operate and maintain development projects. These made self-reliant development very difficult. The goals and objectives of Canada's ODA program were long-term. They aimed at supporting the reform process in Bangladesh by influencing policy changes and strengthening institutional capacity for sustainable development, and by transforming donor dependency into a partnership based on greater self-reliance. This represented a move away from CIDA's former capital-intensive approach in the energy and railway sectors.

CIDA is currently finalizing a new program framework for Bangladesh. The new framework will not represent a dramatic departure from the direction outlined 1991, given that the fundamentals underlying Bangladesh's development dilemma have not changed significantly since then.

Bangladesh was one of the countries selected for our 1993 audit. Sustainability of projects was one of our major concerns. Some of the projects included in that audit are still ongoing. During our 1998 audit we wanted to see what changes the Agency had made to improve sustainability. We selected five projects; three had been in existence since before 1993, and two of those were among projects we examined in 1993. Since then, CIDA has made major changes in the projects to enhance their potential for sustainability. In general, we found that CIDA had taken steps to address our 1993 concerns.

To enhance the possibility of sustainable developmental results, one project we examined was redesigned as a result of lessons CIDA had learned during the initial years of implementation.

The Rural Maintenance Project was initiated in 1983 as a small pilot project. It is now in its third phase. Phase I (1985-89) was originally designed as a relief project to employ destitute women to maintain rural roads year-round. There was no limitation set on the duration of employment during the early period of the project, and there were no plans for the transfer of the project to the Government of Bangladesh. Phase II saw a further expansion of the project. CIDA undertook evaluations during the course of the project in 1992 and 1993. As a result of the 1992 evaluation, the project was redesigned. Phase II saw the inclusion of an income diversification component.

The income diversification component of the redesigned project provides skills training to the women so that when they leave the project they can earn a living. During their four years of employment, the women accumulate savings through a 19 percent holdback in wages, and are trained in "life skills" such as arithmetic and household budgeting and in possible means of self-employment for income generation. They "graduate" from the program after four years, and others are recruited into it. During Phase III, which started in 1995, the redesigned project employed approximately 36,000 women.

The project provides for the gradual transfer of more ownership and responsibility for road maintenance from CIDA and the Canadian executing agent to a ministry of the Government of Bangladesh. Financial responsibility for the payment of salaries to the women is increasingly borne by the Government of Bangladesh. The skills development and training components of the project are also being shifted to a new Bangladeshi entity.

The 1995 agreement with the Government of Bangladesh stipulated that it would increase its contribution to the women's salaries to 90 percent from the original 10 percent by the end of Phase III in June 2001. In 1998 CIDA agreed to reduce this commitment to 55 percent by July 2000. In 1998, the Bangladesh contribution was 35 percent.

Another project we examined showed a delay in effective action to ensure stronger commitment by the recipient organization. Warning signs that called the project's sustainability into question had been present for several years.

The Bangladesh Rail II project was approved in 1986 at a value of \$99 million over a period of 10 years. It was aimed at improving

the capabilities and performance of repair and overhaul workshops. Stage II was started in 1994. In 1995, the agreement with the Bangladesh government was extended to March 2000. The project goal was to increase locomotive availability, productivity and traffic volumes and thus Bangladesh Rail's revenue. It was part of a larger strategy supported by another major donor that aimed to commercialize the railway, currently run by the government.

In 1990, after a major assessment of the viability and relevance of the project, CIDA set out the key conditions and the inputs required from Bangladesh Rail (BR) as a condition of CIDA's continued involvement. Due to the size of the project and its complexity, CIDA engaged an agency to assist in the management of the project. Monitoring missions reported that although progress was being made, project results for Stage II were slipping. Bangladesh Rail was not living up to its promised level of support for the project. For instance, it did not provide the full budget to meet the target for locomotive overhauls. CIDA held meetings with BR and agreed to new targets. Again, these were not met, or were met only partially. It became evident that from the outset the project had not enjoyed the necessary visibility and commitment among the top management of the railway.

Finally, in June 1997, the project manager concluded that due to a lack of effective progress by Bangladesh Rail, the sustainability of the Rail II project was in serious doubt. While continuing its funding, CIDA re-evaluated the project in the ensuing months and considered the options of continuing or not. As a result of the assessment, CIDA informed BR that continuation of the project was in doubt. BR senior management then pledged stronger commitment to remedy the situation and to support the project. It submitted a detailed time-bound action plan to address the concerns. It increased the maintenance budget and developed a plan for a new organizational structure for locomotive maintenance and rolling stock.

CIDA decided to continue, but modified the scope of the project. It refocused some aspects to link to the corporate reforms of BR that it considers essential to long-term sustainability. It plans to reassess the project on an annual basis to ensure that established targets are being met and that the achievements are indeed sustainable. CIDA's disbursements to the end of 1997 totalled more than \$70 million.

Bolivia

In 1995 CIDA designed a Bilateral Program Framework for Bolivia that set out the goals and objectives of Canada's ODA program for the ensuing five years. The document identified program themes, a series of proposed program elements or projects, an assessment of risks, and a number of expected results.

CIDA's bilateral assistance to Bolivia is centered on two themes:

- improving the long-term income-earning potential of poorer Bolivians; and
- supporting the reform initiatives announced in a 1993 master plan by the Bolivian government and translated in 1994 into five priority reform programs.

CIDA's program themes were closely related to the reforms. The program it proposed would build on past Canadian assistance to Bolivia, notably in such fields as the hydrocarbon sector, the health sector, support to groups providing credit to micro-enterprise, and public sector reforms.

At the 1994 meeting of the World Bank Consultative Group, the Government of Bolivia received strong indications of donor support. CIDA is one of the smaller donors to Bolivia, with a bilateral country program of \$7 million per year in 1997-98.

CIDA identified the challenges and risks to achieving the expected results, and identified a number of principles to be followed to minimize those risks. A midterm review to assess progress against the expected results of the strategy was planned for 1998.

We examined five projects in Bolivia. Many of CIDA's projects in Bolivia were "softer" in nature and were focussed on capacity building. The projects appeared to demonstrate a strong focus on results.

CIDA's largest project, at just over \$11 million, involved the hydrocarbon sector. This project demonstrated a focus on results, good risk management and attention to sustainability. Project objectives and outputs were developed jointly by the recipient organizations and the executing agent. The recipient organizations nominated a "champion" at a senior level with decision-making authority. The Bolivian government provided access to its highest levels of decision making. During the project's implementation, regular technical and management review meetings took place with senior levels of government and the state oil and gas company. The recipient Bolivian organizations provided dedicated personnel and subsidized the costs of Canadian advisors. Monitoring the risk factors and adjusting the project accordingly contributed to moving the project forward.

To date, large sections of the company have been capitalized, the legislation has been enacted, the regulatory body and the regulatory framework have been established and they are being administered by the Bolivian government. Those were among the expected results

of the project.

Estonia

CIDA manages its aid to Estonia under a transition strategy whereby aid will gradually decrease, and end definitively in 2005-06. The strategy was based on CIDA's Regional Framework for Central and Eastern Europe. The Estonian government aims to expeditiously meet the necessary standards for participation in the European Union market. Our discussions with Estonian government officials and project partners demonstrated a general agreement with the CIDA strategy and deadline.

Aid to Estonia is not classified as ODA. Project planning and implementation there have differed in some respects from ODA projects. Initiatives for projects often emerged domestically from Canadians with ties to Estonia, and CIDA's involvement was usually responsive rather than proactive. CIDA has encouraged projects to acquire funding from

other donors and has placed a strong emphasis on local involvement. The program has acknowledged the fast pace of change in Central and Eastern Europe and has encouraged flexibility in project planning and implementation. The program recognizes that it should not have unrealistic expectations for its overall impact in the countries. Its aim has been to support specific aspects of the reform process by addressing bottlenecks and capitalizing on opportunities within the transitional time frame.

We audited 11 projects in Estonia. They included some projects that were also operating in Latvia and Lithuania. Most projects had resulted in clear sustainable benefits. We noted a consistent focus on results by CIDA managers, Canadian executing agents and local partners. We also noted some weaknesses in risk management. In the absence of ongoing risk management, CIDA dealt with the problems related to previously identified risks by applying additional resources through expansion or extension of the projects.

Senegal

In June 1997, CIDA established a country profile for Senegal. It describes the social, economic and environmental situation in Senegal, the local government strategy for development and the Canadian strategy for aid intervention. CIDA's development strategy in Senegal takes into consideration the strategy of the Senegalese government and is in line with the Agency's strategy in West Africa. However, the country profile does not identify expected results, nor means to measure performance at the country program level. We also found that for most projects we examined in Senegal, the Senegalese contribution was provided mainly by the counterpart fund, financed entirely by CIDA. This new country strategy did not address that issue, although it is critical to ensuring the sustainability of results. At the time of our audit, CIDA told us that it was negotiating with the Senegalese government to address this situation. For the five-year planning period, CIDA's programming in Senegal will focus on education, good governance and support to the private sector. Although CIDA is not one of the major donors, its support to Senegal has been consistent for many years at approximately \$20 million per year.

CIDA's objective under education is to increase the child schooling rate and to decrease illiteracy. In Senegal, the level of schooling is among the lowest in the world and is still declining. Reversing that situation is an important objective for the government of Senegal and for CIDA. Three of the six projects we examined during our field audit in Senegal are related to education. Two mutually supportive projects to increase elementary schooling rates have so far shown a good focus on results. In 1994, CIDA started a development project with the objective of improving basic education facilities and access. The project had been planned in accordance with the Senegalese national plan for education and in collaboration with other international donors. It used an innovative approach to attract children to primary education, by bringing in the community to participate in the school program. Commitment by local communities and the transfer of expertise to beneficiaries were viewed as requirements for sustainability. CIDA managers adopted a results-based management approach to the project.

In 1996, the other international partners ended their support prematurely, although CIDA managers had not identified that possibility as a risk. To ensure the expected results, CIDA responded on an emergency basis with a second project, to build and furnish classrooms. Progress reports on both projects have presented the status of activities and the results achieved to date, comparing them with the expected results. During our examination of these projects, we observed that the expected results were being achieved progressively. Classrooms were built or renovated with the involvement of the community and furniture was manufactured, both at considerably lower cost than expected. School programs were redesigned to enhance the community's interest, consequently increasing child participation. Local partners viewed the projects as successful and the government of Senegal expressed its intent to use it as a model approach for the country.

Our examination of another literacy project revealed deficiencies in risk management and results-based management. There was little attempt to identify internal risks; identified risks were ignored; and expected results remain vague.

Project managers of intricate projects do not normally identify complexity as an internal risk. In this literacy development project with a budget of \$15 million, the implementation suffered severe start-up problems. Our analysis indicates that part of the problem was the difficulty of dealing with a plan that called for numerous subcontractors to be managed by an on-site project management team of

two Canadian executing agents and a recipient country project director. So far, results have been far below those expected.

The Senegalese Ministry responsible conducted a risk assessment that identified a number of risks surrounding the project. One that it identified as significant was cost control over the operators (subcontractors). The project proposal, including the risk assessment, was made available to CIDA in February 1995. That same proposal produced the original costing of 10,000 CFA francs per pupil.

On 4 July 1996, CIDA signed a contribution agreement with the Canadian executing agent (CEA). The description of outputs in that contract stipulated that 200,000 people were to become literate over five years. The direct cost of that component was estimated at \$5.6 million.

Two weeks later, however, on 19 July 1996, CIDA's representatives in Dakar reported on the operational planning mission conducted in early July. Their report estimated the costs per student at 22,772 CFA francs. It concluded that the estimate of output should be revised from 200,000 people to 94,111. At the end of our audit, the project manager had not officially revised the output estimate.

CIDA guidelines state that a significant decrease in output represents a cost increase. This cost increase should have been approved by the Vice-President. We noted that the project steering committee decided that the normal 10-month course would be reduced to six months in order to meet the original output goal. This decision was made without any apparent study of its feasibility.

As of July 1998, 18,000 students had passed the Ministry exam and 4,800 more were awaiting their results. The June 1998 Annual Project Progress Report notes that a downward revision should be made in the output goal, as the project is achieving results far below those expected for this module. We were told that negotiations are under way with the Senegalese government on the target number of people to become literate. CIDA terminated the contribution agreement with the CEA in June 1998.

With the implementation of results-based management, CIDA initiated new tools to measure results at the output, outcome and impact levels. For example, in the schooling projects that we audited, progress reports presented some actual results against expected results at the output and outcome levels. However, it was too early to report at the impact level. Two projects will end in 1998 and it will still be too soon to measure their real impact. There is no provision for follow-up on results at the project level after funding by CIDA ends. In addition, there is no provision at the country program level for gathering the basic information necessary to measure the long-term performance of CIDA's intervention. Consequently, there will be no assessment of the overall impact at either the project level or the country program level.

Vietnam

In 1994, CIDA established a Country Development Policy Framework for Vietnam that set out the goals and objectives of Canada's ODA program, a strategy for achieving them, and the expected results. At the time, CIDA had limited operating experience in Vietnam.

Compared with other bilateral donors, Canada's financial commitment in Vietnam is in the middle range, with a bilateral country program of \$15 million per year. Large-scale infrastructure and social development projects are beyond the scope of Canadian ODA resources. Accordingly, CIDA's strategy is to enhance Vietnam's own capacity to address development objectives. It does this through a policy that supports the building of capacity and systems of governance. CIDA's Country Development Policy Framework correctly recognized that the capacity-building approach presents certain risks to the achievement of expected results; and it recognized that individual projects are also vulnerable to these risks. CIDA also developed performance indicators for use in monitoring and evaluating achievements against expected results. Continuous monitoring and evaluation by a corporate monitoring committee were to be an integral part of the strategy. The committee was to meet regularly to review progress toward achievement of results, review constraints or problem areas, assess solutions, and share lessons learned. An evaluation of the Framework was called for in the fourth year of its implementation.

In Vietnam we examined six projects. Four, involving institution strengthening and capacity building, had planned expenditures totalling \$38 million over their initial phase. Three of the four were experiencing some problems, from manageable to serious. The risk that these problems would occur had in some cases been identified earlier, but there was no specific plan for dealing with them. For example, from the outset and more than a year into the projects, CIDA and the country partner did not share a common understanding of what CIDA meant by capacity development and what results were expected from the projects. CIDA underestimated the considerable effort and resources required to reach a common understanding with its Vietnamese project partners. Early expenditures by CIDA had limited value because the country partner was not able to absorb the information provided by consultants from Canada.

As a consequence, in another project (currently in the planning stage) CIDA mounted a particular effort to ensure that all parties understood the purpose of the project and the development result that was expected. CIDA was also looking at options for better oversight of the flow of funds, particularly in the early stages of the project.

Assumptions about conditions for sustainability need to be re-examined regularly in such projects. Their very nature means that the country partner does not have the technical and managerial capability at the outset to sustain the project. Another possible indicator of project sustainability is the level of financial commitment and participation by local partners. In some projects, CIDA provided most of the financing and had to encourage local participation by providing per diem funding or special equipment. CIDA managers pointed out

that they had little choice but to use such practices because other donors commonly provide these kinds of incentive. This raises questions about the potential sustainability of the projects.

The review of the country program's implementation was carried out in the fourth year, as the Bilateral Branch had planned. The draft review report noted that the corporate monitoring committee had met only a few times at the start of the program and was no longer active. It provided an update of the current development context, and discussed lessons learned from the experience of the past four years. It also led to a refining of CIDA's development objectives. However, it did not review progress against the expected results set out in the original development framework.

In our view, this was a missed opportunity. Having made the effort to articulate a set of expected results and possible indicators for measuring and reporting progress, CIDA would have benefited by using them to compare whether actual progress to date met its expectations, whether the results it had expected were realistic, whether the performance indicators were practical, and whether refinements were needed.

21.57 Where a transaction results in a payment into a counterpart fund of less than the full amount paid by CIDA, CIDA project managers should document the rationale for the transaction.

CIDA's response: CIDA will strengthen its procedures to include the need to document adequately the rationale for this kind of transaction in the management of counterpart fund projects.

Institutionalizing Lessons Learned

CIDA has made considerable progress

21.58 In 1993 we were concerned that CIDA did not have an organizational "learning culture". We urged the Agency to institutionalize lessons learned at the project and country levels. In response to our comments, CIDA agreed to initiate a simple and clearly understood mechanism that would allow lessons learned to be captured and accessed.

21.59 CIDA undertook formal and informal steps to strengthen its learning culture. Lessons learned are an integral part of the Policy for Performance Review and the Results-Based Management Policy Statement. They are one of the key elements of the Annual Project Progress Reports and the end-of-project reports, and are incorporated into branch-level achievement reports. Lessons learned are being synthesized as part of each corporate review carried out by the Performance Review Branch. The Agency has set up various vehicles to gather and disseminate lessons learned. Examples of these vehicles are the President's Forum on best practices, and informal networks such as the results-based management practitioners' network and others that discuss areas like Women in Development, and Environment.

21.60 CIDA has made considerable progress in incorporating the concept of lessons learned into the results-based management approach. The system for capturing lessons learned relies mainly on the APPR. The quality of information on lessons learned varies considerably among APPRs. CIDA needs to do more to consolidate, analyze and disseminate this information to make it useful to staff. Otherwise, the risk is that project staff will not see the exercise as useful and its value to the organization and to performance reporting will be lost.

Audit and Evaluation

Further effort is needed on performance review

21.61 In July 1994, CIDA introduced its Policy for Performance Review. This policy established a framework for the audit and evaluation functions and has had the effect of creating a closer connection between the Performance Review Division and operational branches at CIDA. The Policy also called for a Performance Review Committee with membership drawn from inside and outside CIDA, in order to demonstrate an openness to renewing performance review and to benefit from the experience of other departments. However, this committee met only twice, in 1995. We were informed that the Executive Committee performs this role now. In 1997, the Performance Review Division obtained Branch status and began to report directly to the President of CIDA, and its Director-General became a member of the Executive Committee.

21.62 In 1995, CIDA reported to Parliament that it planned to conduct performance reviews of the six ODA programming priorities over the next three years. However, significant slippage has occurred. To date, the Performance Review Branch has undertaken three reviews covering two of the priorities. The Branch indicated that these reviews had proved more complex and costly than planned. The reviews also incorporated a more comprehensive approach, designed to identify implications for policy development in the ODA priority areas as well as lessons learned from individual projects. In addition, the Branch was assigned the lead role in the development and implementation of results-based management across the Agency. The remaining reviews of the ODA priorities have now been rescheduled over the next few years.

21.63 We noted that the Policy for Performance Review did not address concerns we expressed in 1993 about project evaluations (now called management-led operational reviews). We felt then that there was a need to guard against a perceived lack of objectivity, mainly because project evaluations were commissioned by the Geographic Program staff. There was no ongoing quality assurance function in CIDA that examined whether minimum evaluation standards had been met.

21.64 The Branch has since undertaken several initiatives to help ensure more consistent quality of operational reviews. It has encouraged use of the Framework of Results and Key Success Factors as the basis for these reviews, and has established a standing offer list that Geographic Program staff can use to contract for the services of performance reviewers. In addition, on request the Branch provides guidance on the conduct of operational reviews.

21.65 These initiatives represent progress, but they still do not address our concerns. We believe that the Agency needs to monitor at the corporate level whether expected quality standards are being met.

21.66 **The Performance Review Branch should selectively review the quality of operational reviews conducted by the geographic branches as part of its regular audits and evaluations.**

CIDA's response: CIDA will, on a selective basis, review the quality of the operational reviews conducted by the geographic branches as one of the lines of inquiry in its audits and evaluations.

Conclusion

21.67 The Agency is now well into the renewal program it began in 1994. The framework for results-based management along with supporting policies and guidelines have been developed and communicated to CIDA's staff and development partners. We concluded that CIDA's actions have addressed the main concerns we raised in our 1993 Report. However, while a more determined focus on results is evident at the levels of country program and project delivery, progress in implementing results-based management has been uneven.

21.68 The Agency needs to maintain its momentum toward implementing management for results. In focussing on results, it needs to take a harder look at whether country programs or projects should be continued, scaled back or rethought when expected development results are at risk because of changes in critical underlying assumptions, absence of essential conditions for sustainability, or other factors that could have an adverse impact. The Agency also needs to monitor projects in a cost-effective way after their completion to determine whether expected results have been achieved.

21.69 The Agency has developed a performance reporting system that starts at the project level and ends with its Performance Report to Parliament. Both internal and external reporting can be improved by including information on expected as well as actual results at the project and country levels, and by presenting a more balanced picture of accomplishments, difficulties and challenges in delivering development assistance.

21.70 All donors recognize that it is difficult to measure development results at the country or program level. However, the Development Assistance Committee of the OECD is developing a working set of core indicators to measure development progress at a level higher than that of the individual projects. CIDA has contributed to the development of these indicators, which are still being refined and tested. As CIDA gains more experience in results-based management, indicators such as these or others that may emerge could provide it with a means of reporting program results to Parliament.

About the Audit

In 1994, CIDA and the Office of the Auditor General agreed that we would conduct a phased follow-up of our 1993 audit of CIDA's bilateral programs for official development assistance. The work would focus on actions taken by CIDA to address the main concerns raised in our 1993 Report. This audit represents the third and final phase of the "phased follow-up" approach.

Objectives

Our objectives were:

- To assess the extent to which CIDA's actions in implementing a results-based management approach have satisfactorily resolved the main concerns raised in our 1993 Report.
- To review the quality of performance reporting on development results.

Scope and Approach

Our audit continued to focus on CIDA's accountability to Parliament for managing for results. We reviewed the way CIDA plans and manages its bilateral programs and projects, and measures and reports their results.

We used a combined country- and project-based approach to conduct this audit. CIDA identified four country programs: Bolivia, Estonia, Senegal and Vietnam. CIDA believes that these best demonstrate the improvements gained by implementing results-based management in the bilateral development aid program. We added Bangladesh to provide a basis for comparison with our 1993 audit. In each of the identified countries, we selected a sample of projects for audit.

We conducted field work at Canadian missions and project sites in the selected countries. It included review of on-site documentation, as well as consultations with stakeholders such as Canadian and local executing agents, with host country officials and with representatives from other international donor organizations.

At CIDA's headquarters, we examined the process and the underlying reasons for selecting country programs and projects and the process for measuring and reporting their results. We also assessed the extent to which the key concerns raised in our 1993 Report had been satisfactorily addressed.

Our work did not extend to comparing CIDA's performance with that of other organizations providing bilateral aid.

Criteria

The criteria used at the country program level and at the project level were based on criteria proposed in our 1996 Report:

Country level

Results Achievement

- Well-defined objectives that can be reasonably achieved are actively pursued.

Risk Management

- Risks associated with the program and related activities are assessed and managed.

Performance Measurement

- Relevant information on performance is obtained and used.
- The extent to which programs and activities are meeting the Agency's performance expectations is evaluated and understood.

Project level

Results Achievement

- Well-defined objectives that can be reasonably achieved are actively pursued.
- Projects are followed up to determine whether project partners are achieving (or are likely to achieve) planned results.

Risk Management

- Risks associated with the projects and related activities are assessed and managed.

Sustainability

- There is follow-up to assess whether project results are likely to provide sustainable benefits after CIDA's direct funding comes to an end.

Performance Management

- Relevant information on performance is obtained and used.
- The extent to which projects and activities are meeting performance expectations is evaluated and understood.
- Timely action is taken to improve project performance.
- Periodic reports on the potential for results and corrective action taken where appropriate are presented to CIDA's senior management.
- CIDA is providing assurance that money has not been expended for purposes other than those for which it was appropriated.

Institutional level

Learning Organization

- CIDA has created an action-oriented organizational environment that promotes learning by doing, an innovative style of management and an openness to differing viewpoints.

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Chapter 22

The Federal Science and Technology Strategy

A Review of Progress

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The Federal Science and Technology Strategy

A Review of Progress

Main Points

22.1 It has been nearly three years since the government released *Science and Technology for the New Century — A Federal Strategy*. The Strategy outlined three goals to which science and technology (S&T) resources were to be directed. It recognized the need for better management of S&T activities and provided a set of principles to improve their management in departments and agencies.

22.2 In this follow-up to our 1994 audit of the federal S&T effort, we found that progress in establishing the elements required to improve its management has, overall, been slow. The government has not acted fully on some of the commitments it made in the Strategy. As a result, the management regime set up to oversee the federal S&T effort is not yet working as intended by the government — that is, ensuring that priorities are clear, that activities are co-ordinated, and that performance is reported on fully.

22.3 In the departments we examined, progress in acting on the Strategy's seven operating principles has varied considerably. However, even the less advanced departments have moved in the direction desired by the government. More remains to be done, and our follow-up identified three areas that require special attention: mission-driven, results-based research; scientific excellence; and the use of partnerships.

22.4 Some results of the Strategy are now emerging, and we believe it may be time for the government to clearly set out what remains to be done — what is next on the agenda. Along with sufficient leadership and ongoing parliamentary oversight, this would help to ensure that the current Strategy does not become, like similar efforts over the last 30 years, one more missed opportunity.

Introduction

22.5 It is well recognized that science and technology contribute to the country's ability to generate sustainable employment and economic growth. But science and technology go beyond contributing to economic growth; they support our quality of life.

22.6 The federal government invests significant resources in science and technology (S&T) activities. In 1997-98, departments and agencies spent an estimated \$5.45 billion on S&T. The federal government also encourages research and development in the private sector through tax incentives that represent more than \$1 billion annually. Those amounts do not include funding for the Canada Foundation for Innovation, which in 1997 received a federal grant of \$800 million to provide new infrastructure support to university and medical research and development.

22.7 Given the importance of S&T to our country, and the substantial investment involved, the proper management of S&T activities is of paramount importance. In our view, there are two fundamental questions to ask about the government's S&T performance:

- To what extent has the government clearly established what it wants to achieve with its S&T activities?
- To what extent is it managing S&T activities in a way that maximizes value for money?

Previous audit findings

22.8 In an attempt to answer those two questions, in 1994 we conducted a sectoral audit of federal science and technology activities. The results were presented in four interrelated chapters of our 1994 Report: Overall Management of Federal Science and Technology Activities, Management of Departmental Science and Technology Activities, The Management of Scientific Personnel in Federal Research Establishments, and Income Tax Incentives for Research and Development.

22.9 In its 1994 Budget several months before the publication of those chapters, the government had announced a fundamental review of its S&T effort aimed at giving Canadians a federal strategy with "real priorities, real direction, and a real review of results".

22.10 Our 1994 report documented the failure of previous such efforts in the last 30 years. Indeed, we said that there had been much activity but few results. In our view, some of this lack of progress could be attributed to a lack of overall government-wide leadership, direction and accountability. Accordingly, we presented lessons learned from past efforts for the government to consider in its announced review.

22.11 In brief, our observations were that the federal government needed to provide:

- clear priorities and clear direction for its S&T activities;
- clear performance expectations and action plans;
- effective co-ordination and oversight;
- leadership that transcends departmental mandates; and
- better information for Parliament and the public on S&T activities and performance.

22.12 In 1995, the government launched Program Review, a government-wide initiative aimed at rethinking and realigning government programs in light of fiscal restraints. Program Review had a major impact on some science and technology departments. For some departments it also constituted a priority-setting exercise involving senior officials and ministers. During the same period, the government started to revise its Expenditure Management System (EMS) to improve the information provided to Parliament on expenditure management, planning and performance. An integral element of the EMS was the Treasury Board's requirement that departmental Business Plans be submitted to it for review.

22.13 In March 1996, the government published *Science and Technology for the New Century — A Federal Strategy* (the Strategy). Through the Strategy, the government set out three goals for the federal investment in S&T:

- to ensure that Canada is among the best in the world in applying and commercializing S&T for sustainable job creation and economic growth;
- to ensure that Canada applies S&T to improve the quality of life for our citizens through the creation of fulfilling jobs and through the most effective social, environmental and health care programs in the world; and
- to create in Canada world centres of excellence in scientific discovery, to build a broad base of scientific enquiry, to foster Canadian participation in all major fields of science and technology, and to ensure that new knowledge can be acquired and disseminated widely from Canadian sources and from around the world.

22.14 The Strategy provided direction to departments and agencies and set out the elements of a federal governance system for their S&T activities through which to achieve these goals. The Strategy document was accompanied by action plans from departments and agencies involved in S&T. The government also released its *Framework for the Human Resources Management of Federal Science and Technology Community*.

22.15 In a follow-up chapter published in September 1996, we welcomed the S&T Strategy, noting that it addressed certain government-wide concerns we had raised in our 1994 Report. We found that science-based departments had made plans to focus their science and technology activities and set priorities. The Strategy provided direction to departments and agencies in the form of operating principles for conducting many aspects of their science and technology activities. We observed that departments and agencies had recognized the advantages of working more closely together. Various initiatives were also under way to improve the assessment of results and impacts of federal science and technology activities, and to report on the growth of Canada's knowledge-based economy.

22.16 However, in our view the Strategy had left some "unfinished" business. For example, even though a mechanism had been established to make recommendations to Cabinet on S&T priorities, government-wide priorities had not been enunciated. We noted the critical need for the government to monitor the Strategy's implementation and to devote considerable attention to establishing results-oriented, time-phased implementation plans. This would help ensure that the direction provided to departments and agencies would become an integral part of day-to-day management in science-based organizations. We noted that accomplishing this would require leadership and perseverance at all levels of government. We also said that parliamentary oversight was key to ensuring that it happened.

Focus of the follow-up

22.17 Given the importance of the Strategy and the fact that two years have passed since our last follow-up, we believe the time is right to build on our earlier work with a review of the progress made in implementing the S&T Strategy. This follow-up chapter provides our assessment of progress to date in:

- meeting the Strategy commitments to establish new institutions and mechanisms for management; and

- acting on the operating principles set out for departments by the government.

22.18 We looked at the progress made by four departments with significant direct involvement in S&T: Agriculture and Agri-Food Canada, Fisheries and Oceans, Environment Canada and Natural Resources Canada. As a case study (see page 22-14), we also assessed the management of climate change science activities — looking specifically at the extent to which it manifests the principal commitments of the Strategy. Given the limited sample size, the results discussed in this chapter should not be generalized to all science-based departments and agencies.

22.19 Details on the objectives, scope and approach of our work are included in **About the Follow-up** at the end of this chapter.

Observations

Important Challenges Still Lie Ahead

22.20 In the course of its science and technology review, the federal government received a number of suggestions for changing the structure and processes of its decision making on science and technology. The government intended to respond by creating and reorganizing institutions and mechanisms to improve the governance of S&T.

22.21 In the Strategy, the government recognized that to be a more effective partner in the country's innovation system, it needed to get its own house in order. It concluded that achieving greater coherence while preserving flexibility, responsiveness and ministerial accountability would require a more rigorous collective review of priorities and greater co-ordination of activities.

22.22 Accordingly, the Cabinet Committee on Economic Union (CCEU) was mandated to annually review the performance of federal S&T activities and recommend priorities to Cabinet. To facilitate its review of S&T priorities, the CCEU would receive advice from a new body, the Advisory Council on Science and Technology, which replaced the National Advisory Board on Science and Technology.

22.23 The Strategy also stated that improving top-level advisory and decision-making structures was not enough to ensure that the federal government's substantial investment in S&T would yield better results. The government recognized that to improve the management of its investment, it needed more co-ordination of S&T activities among federal agencies and collaboration on major horizontal issues — those that cut across departmental and agency boundaries. The Minister of Industry would lead the co-ordination of S&T policy and strategies across the federal government. This effort would be supported by another new body, the Council of Science and Technology Advisors.

22.24 The intended interactions among the new and renewed institutions are presented in Exhibit 22.1.

Exhibit 22.1 is not available, see the Report.

22.25 The Strategy contained other specific commitments:

- development of new measures to increase the accountability of individual departments and agencies for the management of their S&T;
- implementation of a Framework for the Human Resources Management of the Federal S&T Community;

- creation of a new S&T information system; and
- new direction for intergovernmental co-ordination and co-operation.

22.26 Two years after our previous follow-up, we expected to find the new institutions and mechanisms in place and to see indications that they would soon be working well. Overall, however, we found slow progress in establishing the new management system, and some commitments have not been addressed adequately. As a result, the system is not yet working as the government intended — that is, ensuring that the federal S&T management system has clear priorities, co-ordinated efforts, and full reporting on performance. In this section, we describe our specific concerns about what has been done so far, and indicate the remaining challenges that must be met if the system is to work well.

Elements of the management regime are in place

22.27 The Advisory Council on Science and Technology was created in July 1996. Comprising 11 members, it is chaired by the Minister of Industry and supported by a secretariat in Industry Canada. Its mandate is “to review the nation’s performance in S&T, identify emerging issues and advise on a forward-looking agenda”. Initially, it intended to work on three specific issues: human resource challenges as Canada moves to become a more knowledge-intensive society; the potential for commercializing Canadian research; and development of a more coherent and publicly accepted vision for the future of science and technology in Canada. The Council was to also advise the Cabinet Committee on Economic Union (CCEU) on priorities for science and technology. Its first meeting with the CCEU (and the only one to date) was in December 1997.

22.28 The Council of Science and Technology Advisors was created in May 1998 and first met in October 1998. Its 22 members are drawn mostly from the advisory committees of science-based departments and agencies. The Council is chaired by the Secretary of State for Science, Research and Development, and will report to the CCEU. Supported by an Industry Canada secretariat, the Committee will look at S&T issues internal to government that require government-wide strategic attention. The CCEU has asked the Council to begin looking at the federal government’s roles in conducting S&T and at its ability to fulfil those roles; and to develop a set of guidelines on the use of scientific advice in government decision making.

Committees have not reached full potential

22.29 Although the Strategy in 1996 indicated the need for more external support for the co-ordination of S&T activities, it was not until May 1998 that the Council of Science and Technology Advisors was created. We are concerned that by the time it eventually makes recommendations, opportunities to address important horizontal issues will have been significantly delayed. For example, as already noted, the Council has been mandated by the CCEU to look at the government’s roles in conducting S&T activities and at its ability to fulfil those roles. In our opinion, this is an issue that needs to be tackled as soon as possible because of its impact on the way science-based departments and agencies conduct their business.

22.30 The Assistant Deputy Minister Committee on Science and Technology (ADM Committee) is composed of senior officials at the assistant deputy minister level from science-based departments and agencies. It provides the government with the capacity to deliver on its collective responsibility for policy co-ordination and management of federal S&T. In 1996, we asked what specific role the Committee would play in the implementation of the Strategy. In 1997, the Committee’s terms of reference set out its revised mandate:

- to implement the cross-government commitments made in the Strategy;
- to develop proposals and advice to the government on key horizontal S&T policy issues; and

- to provide a forum for interdepartmental consultation on S&T policy and program directions, sharing of information, and co-ordination of efforts and initiatives across the federal S&T system.

In addition, the new mandate given to the Council of Science and Technology Advisors calls for close collaboration with the ADM Committee.

22.31 Although it does not have a direct link to Cabinet, the ADM Committee could play an important role in the management system. Under the Strategy, however, it has no formal responsibilities for co-ordination — a crucial gap, in particular since the Council of Science and Technology Advisors was not created until May 1998.

22.32 Given its mandate, we expected that the ADM Committee would provide a forum for discussing issues of common concern as well as a vehicle for getting things done. We found that the Committee has discussed many issues and created working groups to deal with them but few initiatives of these working groups have reached the implementation stage. One notable exception was the Committee input to the publication in 1997 of the first annual report on S&T activities.

22.33 We found that some issues have been “ongoing” for a long time. For example, a framework for international S&T was to be established to meet one of the Strategy commitments: the development of explicit plans to promote international S&T collaboration for the benefit of Canadian firms. The final framework was to be completed in March 1997 but, more than a year and a half later, it is still not finalized. Revising the Intellectual Property Policy was another commitment in the Strategy. A second round of consultations is now under way but, after two years, nothing has been finalized.

22.34 In our opinion, since the ADM Committee is an essential part of an effective co-ordination system, the government needs to clarify what it expects the Committee to accomplish. Beyond this, to be effective the Committee requires strong, consistent leadership and secretariat support. Members of the ADM Committee need to consider ways to ensure that it fulfils its potential.

How committees will work together is unclear

22.35 We had expected the government to ensure that the respective mandates and work plans of committees were integrated so that the S&T management system would operate as effectively as possible.

22.36 While the Council of Science and Technology Advisors was to provide an external perspective on internal federal management of S&T, the Advisory Council on Science and Technology (ACST) would be expected to provide its views on broader issues, beyond internal management — for example, science and technology and youth. However, it would be reasonable to assume that the two bodies would complement each other’s work on specific issues.

22.37 Since it is important that these two bodies work well together and with the ADM Committee, we would expect to see clearly how they would interact. In our view, three ingredients are essential: a work plan for each of them, regular interaction and an ongoing exchange of information.

22.38 A work plan is essential to identify what needs to be done, when and by whom. It would also help in tracking progress on issues and in holding officials accountable for results. The ACST has identified certain issues to address. The recent creation of two expert panels on skills in knowledge-intensive industrial sectors and the commercialization of university research provides a better idea of how two of these issues will be dealt with. However, there is no further indication of how and whether the ACST intends to work on the third issue identified (the development of a publicly accepted vision for the future of S&T in Canada) or whether any other issues will be looked at while the panels produce their reports. The Council of Science and Technology Advisors will also need to set out its goals and a work plan. At the end of our review, we were informed that a work plan was being drafted.

22.39 In February 1997, the ADM Committee decided that it needed a work plan to help implement the government-wide commitments made in the S&T Strategy. The work plan was to be based on the deliverables indicated in the Strategy. The ADM Committee also believed that it needed to prioritize the deliverables and identify those it would address over the next year. However, officials have informed us that the ADM Committee never produced such a work plan.

22.40 We found some links among the three bodies. For example, the ADM Committee was informed regularly of the work done by the ACST. The terms of reference for the Council of Science and Technology Advisors state that it will work in collaboration with the ADM Committee on horizontal issues; they are also supposed to meet together at least once a year. As well, a Deputy Chair of the ACST (to be appointed) will serve as an ex-officio member of the Council of Science and Technology Advisors. However, since this Council has just been created, we cannot comment on how well integrated their respective work plans will be.

22.41 In our view, Industry Canada has a key role to play in making all of this happen. We encourage it to ensure that appropriate linkages exist among the three bodies.

Need to move beyond co-ordination to collective action

22.42 In our 1996 follow-up report we said that the government's science and technology review had made science-based organizations more aware that they needed closer ties and improved relationships to tackle certain issues successfully. New initiatives mentioned at that time are now well under way, like the Federal Partners in Technology Transfer that involves 14 departments. Another is the Memorandum of Understanding (MOU) to foster collaboration and co-ordination in S&T for sustainable development, signed by all four departments we examined. It was recently renewed and now includes Health Canada. Other initiatives have followed.

22.43 However, more co-ordination does not necessarily lead to better management of horizontal issues. In our view, effective management of any important horizontal issue needs to include an action plan that orchestrates the relevant activities of departments and other players involved to achieve agreed-upon objectives; an accountability framework that transcends departmental jurisdictions; and a joint reporting mechanism to track results in relation to objectives. While we did not examine co-ordination among departments per se, we looked at the management of climate change science to see whether there was evidence of good co-ordination and collaboration in practice.

22.44 While the MOU in S&T has been an important step in co-ordinating science efforts in climate change, it does not fulfil our expectation for joint goal setting and research planning and a common management framework. Nevertheless, there are signs that the federal government is moving beyond co-ordination to collective action, with the adoption of a new management framework. The case study on page 22-14 contains our findings. It appears that the renewed National Biotechnology Strategy is also adopting a promising approach, although it was not part of our review. We hope that those experiences will lay a new foundation for the management of other horizontal issues.

Management of Federal Activities in Climate Change Science

The purpose of this case study was to determine whether the federal government's management of its climate change science activities reflects the key commitments and principles of *Science and Technology for the New Century — A Federal Strategy*. In other words, we wanted to know whether the federal government was putting the Strategy into practice in this area.

The management of climate change science to this point does not reflect fully the intent of the commitments made in the Strategy. However, efforts are under way to better manage climate change science. We hope that these efforts will lay a new foundation for the management of other horizontal issues.

Introduction

Canadians have been participating actively for many years in researching and monitoring global climate change. In conjunction with a

number of stakeholders, federal government departments have prepared several reports stating that the effects of climate change on Canada are potentially serious. They note that the burning of fossil fuels, population growth, and changes in land use such as deforestation are producing global climate change, and that Canada is vulnerable to this change. Even with reductions in greenhouse gas emissions, changes in climate will continue and Canadians will have to adapt.

Effects are expected on every region and sector, particularly agriculture, forestry and fisheries. Significant direct adverse effects could include changes in precipitation patterns leading to drier summers in the Prairies and central Canada, an increase in forest fires and insect infestations, changes in migration patterns of fish stocks, coastal flooding from rising sea levels, extensive thawing of permafrost in the north and more frequent severe weather events. While many of the effects of climate change are expected to be negative, there could be some potentially positive effects in some parts of Canada, such as milder winters and a longer growing season.

Because climate change is a global problem, research on climate change requires international collaboration to generate scientific data on a global basis. A large component of Canadian research is linked to one or more of the three major programs developed by the international research community to address specific questions related to global change: the World Climate Research Program, the International Geosphere–Biosphere Program, and the International Human Dimensions Program. These programs have identified many key scientific problems that need to be addressed on a global scale, and have developed scientific rationale and plans to resolve these questions. This is the context in which the planning and implementation of Canadian research on climate change takes place.

The Canadian research effort involves many players: the federal government, the provincial and territorial governments, the academic community, the private sector and community interest groups. The Canadian Climate Program Board, an advisory body composed of individuals from the federal and provincial governments, the academic community, the private sector and non-governmental organizations, co-ordinates climate-related activities in Canada. It provides advice and information on climate change and variability by communicating with a wide audience, including individuals and organizations involved in activities that contribute to the Canadian effort.

What departments are doing

Several federal departments are involved in research to better understand aspects of the

climate system and determine the potential and measurable impacts of climate change on ecosystems. Our expectations for interdepartmental collaboration flow directly from the Strategy and are discussed under three broad areas: common goals, shared work and joint performance review and reporting.

Common goals. Given the horizontal, integrated nature of climate change science, we expected that the efforts of individual departments would be guided by a common management framework. Such a framework would set out the objectives for a comprehensive federal effort that would include participation by relevant players outside the federal government. Determining research objectives in a global research endeavour such as climate change involves answering three questions: What knowledge do we need? Should Canada develop this knowledge? If so, who in Canada can do it?

The introduction in 1995 of the Memorandum of Understanding (MOU) on S&T for sustainable development among the four natural resource departments led to the creation of a working group on Climate Change and Variability. This working group has been identifying the current state of knowledge, the research questions that need to be addressed, and priorities for action by the four resource departments. In 1998, Health Canada was added to this MOU.

While the MOU has been an important step in co-ordinating science efforts, it does not fulfil our expectation for joint goal-setting and research planning and a common management framework.

In our view, it is important that the federal government formally identify corporate goals and plans for research into climate change through a comprehensive approach involving all relevant federal sectors and external stakeholders. Moreover, given the global nature of the issue and the need to link the Canadian effort with the international one, the goals and plans should identify the appropriate niches for Canadian contributions to the international research effort. Without common goals and plans, climate change science may simply be a collection of individual departmental programs or projects in the same broad area of scientific inquiry, rather than a deliberately orchestrated set of research activities aimed at resolving specific issues or problems.

Shared work. The Strategy identifies the need to improve interdepartmental collaboration and co-operation in S&T activities in order to optimize the use of resources. For the management of climate change science, we expected to find an overarching structure that would link the research activities of various departments required to achieve common goals. That is, it would identify the research to be done and by whom, and by when. It would also estimate the cost of doing the research and identify the source of funding.

We did not find an overarching structure to manage the research and the resource requirements. However, the existing mechanisms do

enable the principal departments to work together and with partners outside the federal government. For example, Environment Canada has the Canadian Climate Research Network, which has mobilized the academic community across Canada and helped to co-ordinate aspects of government/university efforts. Natural Resources Canada has the Climate Change Network in the Canadian Forest Service and the Program of Energy Research and Development in the Energy Sector. In addition, the MOU on S&T for sustainable development has facilitated joint activities.

In our opinion, while these mechanisms go partway toward encouraging collaboration among departments and with external partners, in the absence of a comprehensive federal approach to the science of climate change based on common goals and clear expected results there could be gaps, duplication and wasted efforts in the research that is undertaken. To fulfil the spirit of the Strategy commitment on interdepartmental collaboration, we expected the government to adopt an approach to the science of climate change that would transcend individual departmental programs. In our view, some of the research efforts that are needed may not fit neatly into existing programs; all the necessary players may not be involved; and there is no clear mechanism for responding to new resource requirements.

Joint performance review and reporting. Performance review and reporting are important principles of the Strategy. Every department and the federal government as a whole are accountable for the research results achieved and for reporting on those results.

Performance review and reporting are essential for two reasons. First, they allow the government to adjust its goals and research plans in the light of new information and to deploy the resources required to achieve the goals. Second, they provide the basis for parliamentarians to assess whether the government's expenditures on science and technology reflect Canadian needs and opportunities, and to hold the government accountable for results. We expected that the government would develop means to review and report on the results of the federal research effort into climate change science either collectively, or separately in a way that would make clear the full extent of the federal effort.

We found that climate change research is reported on a departmental basis, in order to align reporting with financial accountability. The existing departmental reporting mechanisms may limit the ability of the federal government to review and report on the joint federal efforts in climate change research, as well as Parliament's ability to undertake proper oversight. An alternative approach might include reporting fully in the Performance Report of a lead department, and in a summary way in the others'.

We believe that better joint performance review and reporting as part of a government-wide process that involves stated goals and research plans and shared work would improve the management of climate change and accountability for its results.

What departments are planning

As part of meeting Canada's Kyoto commitments to reduce greenhouse gas emissions, the Climate Change Action Fund was announced in the 1998 federal Budget. It has been allocated \$150 million over three years, with an objective to leverage further funds from government and private sector organizations. It operates in four areas: foundation building, public education and outreach, science and adaptation, and technology.

The federal government is currently developing business plans for actions to be taken under the Climate Change Action Fund. We reviewed the proposed business plan for one of the four areas, science and adaptation, and found that it appears to address many of the weaknesses we have discussed in the government's approach to date.

The business plan identifies common objectives and goals toward improving knowledge of climate change science. It builds on the planning activities that have taken place to date, such as the outputs from the MOU working group on climate change and variability, to identify gaps in the knowledge of both science and adaptation. It provides a general work plan that identifies the science and adaptation activities to be emphasized. A detailed work plan is being developed that will elaborate on specific deliverables, funding and timing.

A key feature of the business plan is the proposed management framework to deliver the goals and work plans we have noted (see the exhibit below). This framework will transcend departmental jurisdictions.

In our view, the proposed structure demonstrates some of the key attributes of an effective management framework for a major initiative involving many stakeholders:

- ministerial commitment;
- an open, transparent process of agenda setting and developing work/action plans;
- a supportive and funded secretariat to provide the necessary linkages across a complex set of structures;
- a defined schedule of outputs, provided to ministers and against which performance can be measured; and
- a structure to respond to requirements for resource allocation or reallocation.

Officials informed us that efforts are now under way to develop collective frameworks of evaluation and accountability to measure and report on results.

Conclusion

Our review of the approach taken thus far in the management of climate change science confirms that addressing horizontal S&T issues in a departmental management regime is an ongoing challenge. The mechanisms that are currently in place enable the participating departments to address research efforts within their existing departmental structures and programs. In our opinion, the management of climate change science to this point does not reflect fully the intent of the commitments made in the Strategy.

The government has recognized that a more concerted approach is needed to optimize resources and co-ordinate research at the federal level and across all sectors, especially in view of its Kyoto commitments. In our opinion, the proposed business plan dealing with science, impacts and adaptation is a better reflection of the principles outlined in the Strategy. We believe that the proposed approach holds the promise of improved management of this horizontal issue.

**Proposed Management Framework for Climate Change Science –
Impacts and Adaptation Component
(Chart not available –see the Report.)**

Review of priorities is incomplete

22.45 As noted in *Minding Our Future*, the first annual report on federal S&T activities, “The Government outlined its priorities in the Speech from the Throne. Investing in knowledge and creativity and developing the workforce for the 21st century are key aspects of the efforts to build a stronger Canada. These objectives will also shape the federal S&T effort in the coming years.” Those general objectives, along with the goals set out in the Strategy (sustainable job creation and economic growth; improved quality of life; and advancement of knowledge), have been translated into spending decisions over the past two years.

22.46 The government has made explicit choices in directing new S&T funds to non-departmental entities like the Canada Foundation for Innovation and the Canadian Network for the Advancement of Research, Industry and Education (CANARIE Inc.). This may reflect a more general approach by government on how it sees it can best achieve its stated objectives.

22.47 These and other spending decisions implicitly represent priorities of the government. However, in the Strategy, the government stated that it needed to conduct a more rigorous review of priorities. We would have expected that, at some point, the government would indicate the results of its rigorous review. This has not yet happened. The government needs to consider how best to communicate the results of this review of priorities to Parliament and other interested bodies.

Intergovernmental co-operation and co-ordination have not taken the promised new direction

22.48 The Strategy stated, “An effective governance system for S&T in Canada demands closer co-operation and co-ordination of efforts among governments.” The government recognized that past high-level initiatives,

although well-intentioned, had not resulted in much discernible progress. New approaches were needed to deal with specific issues like overlap and duplication and the sharing of information.

22.49 The federal government's commitments to intergovernmental co-operation and co-ordination are clearly listed in the Strategy. Where appropriate, new institutions and instruments were to be developed to facilitate improved intergovernmental relations, whether through regional or bilateral arrangements. To help shape this process, the government was to initiate results-oriented discussions with provincial and territorial governments. Those commitments established our expectations. Given the importance it placed on enhancing co-operation and co-ordination with other levels of government, we expected that the federal government would make this a high priority on its agenda.

22.50 Since the spring of 1998, Industry Canada has been co-ordinating a network of federal-provincial officials to exchange information on science and technology. The network, led by Industry Canada, has completed an analysis of issues raised by provincial premiers and is preparing an inventory of initiatives taken on those issues. Efforts are now being made to develop an electronic channel of communication. Federal, provincial and territorial deputy ministers of industry met in September 1998 to discuss ways of improving the co-ordination of S&T activities. While we recognize that the development of new institutions and instruments takes time, to date there is little evidence of tangible results.

The government has started to report on its performance

22.51 In 1996, we reiterated the need for consolidated information on the performance of departments and agencies on government-wide and horizontal issues, and on Canada's performance overall in science and technology. In particular, this meant that government-wide performance expectations were needed, along with performance monitoring and reporting to Parliament. In December 1997, the government published its first annual report on S&T activities, *Minding Our Future*. That document states, "This report, the first in a series, provides an overview of the federal science and technology investment, reviews the federal government's performance against the goals outlined in the Strategy, and identifies some challenges that must be overcome in the transition to a knowledge society."

22.52 We believe that the report constitutes a step in the right direction. However, we also found areas for significant improvement. The report needs to focus more on results. If the government wants to review its performance against the goals outlined in the Strategy, it needs to set meaningful performance expectations for each of them. Otherwise, it will be difficult to assess the extent to which the activities contribute to achieving the three goals of the Strategy. For example, the report highlights the various activities undertaken by departments that contribute to the goal "improved quality of life", but does not indicate whether they are sufficient or what remains to be done.

22.53 The report also provides little consolidated information on the performance of departments and agencies in horizontal areas. This kind of information is important to an understanding of spending priorities and as an input for discussions on accountability for priority setting. Although some progress has been made, we believe that parliamentarians do not have a firm basis for assessing whether the government's expenditures on S&T reflect Canadian needs and opportunities, and for holding the government accountable for results.

22.54 We expect that work undertaken by Statistics Canada will help to provide more information on the relationship between government involvement in science, technology and innovation and the three goals outlined in the Strategy. In 1996, Industry Canada funded the Information System for Science and Technology Project, which is led by Statistics Canada. As part of this project, work has been undertaken to provide better information on where the government spends its S&T resources and, more important, what it gets in return. However, the latter issue will require that new indicators be developed and so, building on the work done thus far, Statistics Canada has initiated a Framework for a Statistical Information System — a tool to develop performance indicators for science and

technology activities. The Framework will provide information on outcomes of S&T activities. Statistics Canada officials told us they were preparing a strategic plan to implement the Framework. At the end of our review, funding for this initiative had yet to be finalized.

22.55 The annual report on S&T activities would be a good opportunity for the government to also lay out a forward-looking agenda. This could include the government's views on the work of the ACST and the Council of Science and Technology Advisors, as well as results-oriented implementation plans.

Implementation plans for the Strategy are still needed

22.56 In our 1996 follow-up report we said that implementation plans for various initiatives planned under the Strategy had yet to be prepared. We noted the need for implementation plans that would include key steps, schedules, milestones and resource requirements and that would clearly establish accountability for results. We were informed at the time by Industry Canada that the Minister of Industry would "table a plan for the implementation of a large part of the Strategy in the autumn of 1996". The Minister of Industry outlined implementation elements for the Strategy in October 1996. However, this outline was not supported by an appropriately detailed plan for carrying out the intended commitments. Our review suggests that there is still much to do, and that a plan for doing it would be beneficial. For example, the decision-making structure has been established, but how efforts will be co-ordinated needs to be planned and integrated with work on other outstanding commitments.

Progress in Departments Varies

22.57 As well as making several commitments at the government-wide level, the Strategy stated that a common framework of operating principles was needed to ensure that departments and agencies acted together to reach S&T goals. The principles and associated departmental commitments were also supposed to provide a basis for measuring and evaluating results under the new management regime outlined in the Strategy. The seven operating principles are presented in Exhibit 22.2.

Exhibit 22.2

Common Framework of Operating Principles

- Increasing the effectiveness of federally supported research
- Capturing the benefits of partnerships
- Emphasizing preventive approaches and sustainable development
- Positioning Canada competitively within emerging international regulatory, standards and intellectual property regimes
- Building information networks: the infrastructure of the knowledge economy
- Extending science and technology linkages internationally
- Promoting a stronger science culture

Source: *Science and Technology for the New Century — A Federal Strategy*, Government of Canada, March 1996

22.58 Our follow-up on progress to date in implementing the operating principles covered a sample of four departments with significant science programs: Agriculture and Agri-Food Canada, Environment Canada, Fisheries and Oceans and Natural Resources Canada. Exhibit 22.3 provides a brief profile of the four departments and Exhibit 22.4 shows the financial resources they invest in science and technology activities.

Exhibit 22.3

Science and Technology Activities of Four Departments

Agriculture and Agri–Food Canada	Environment Canada
<p>Agriculture and Agri–Food Canada’s mandate for research and development is “to improve the ongoing competitiveness of the Canadian food and agriculture sector through the development and transfer of innovative technologies”. S&T activities are conducted through 18 research centres across the country. The research centres study soil properties, plant breeding, water use and management, energy, environmental quality, production development including animal crossbreeding, feedlot systems, genetics, processing, distribution, retailing and consumer concerns.</p>	<p>Environment Canada undertakes programs to reduce risk to human health and the environment. It provides weather and environmental predictions and warnings, as well as emergency preparedness services to enhance safety from environmental hazards. Over 80 percent of the Department’s expenditures are on S&T activities and more than two thirds of its employees are classified in S&T positions.</p>
Fisheries and Oceans	Natural Resources Canada
<p>Science in the Department involves the collection, analysis and interpretation of data in the fields of fisheries biology, aquaculture science and oceanography, fish habitat and the marine environment, and hydrography. Using this analysis and interpretation, science provides timely advice in support of management for the conservation, protection, and sustainable utilization of marine and aquatic resources, and for safe navigation.</p>	<p>NRCan conducts leading–edge research in science and technology in the area of forestry, energy, metals and minerals and earth science in order to create and transfer the ideas, knowledge and technologies that Canada needs to use its resources wisely and efficiently, to reduce costs, to protect the environment, and to help Canadians create new products and services. The science and technology activities of NRCan are particularly important for meeting the challenge of sustainable development. The integration of economic, social and environmental considerations into resource decision–making requires a base of sound scientific knowledge.</p>

Source: Statistics Canada

Exhibit 22.4 is not available, see the Report.

22.59 The Strategy stated that the way departments and agencies applied its principles to their S&T activities would vary, depending on their roles and responsibilities. We took this into account in our follow–up. We also had to consider that the departments did not all start from the same point. Some had already been applying a number of the principles outlined in the Strategy when it was announced. Therefore, while we expected each department to be working to apply the operating principles, we did not expect that they would all be at the same stage of progress. However, the experience of the most advanced can help the others to catch up.

22.60 Although we found that progress in acting on the seven operating principles has varied considerably in the departments we examined, even the less advanced departments have moved in the direction desired by the government. Overall, however, much more remains to be done, especially in reporting on performance.

22.61 Our findings suggest that Natural Resources Canada is well on its way to putting the principles of the Strategy into practice. Environment Canada and Agriculture and Agri–Food Canada are following behind, having made progress in some areas but not in others. Fisheries and Oceans, with the smallest expenditure on S&T of the four departments, has made progress on several principles but has yet to make significant progress on others.

22.62 Departments need to consider the merits of assessing their own progress to date on each of the commitments, and to set out plans for fully implementing the Strategy.

22.63 As the departments continue to address the Strategy commitments, in our view there are three departmental science management issues that need special attention: mission–driven, results–based research; scientific excellence; and partnerships.

Mission-driven, results-based research

22.64 In 1994 we recommended that departments set clearer research goals and priorities; focus on achieving results; better identify both potential uses for, and users of, those results; and be held accountable for making these changes. The government accepted our recommendations.

22.65 The Strategy contained several specific commitments aimed at improving information on departmental plans and performance. Each science-based department and agency was to:

- set clear S&T targets and objectives, establish performance indicators based on outputs and develop evaluation frameworks;
- prepare an S&T plan describing and integrating the approach that it would take within its business plan; and
- prepare a report on its priorities, key initiatives, spending plans, management challenges and performance measures for S&T as part of what is now the annual Report on Plans and Priorities.

22.66 Our follow-up review found that none of the four departments had a distinct S&T plan. However, Environment Canada and Natural Resources Canada have made good efforts to describe in their business plans how science and technology activities contribute to the achievement of their policy objectives. We also noted that some sectors of Natural Resources Canada and the Research Branch at Agriculture and Agri-Food Canada have produced their own business plans.

22.67 We found considerable variation in the information on S&T activities presented in the four departments' Reports on Plans and Priorities. More specifically, Agriculture and Agri-Food Canada and Fisheries and Oceans provide far less information than Natural Resources Canada and Environment Canada on S&T priorities and targets, management challenges and performance measures. For example, Fisheries and Oceans provides little information on its science priorities and describes only in broad terms the kind of science it wants to undertake. In contrast, for each of its policy goals Natural Resources Canada provides information on its related science and technology activities.

22.68 Natural Resources Canada and Environment Canada have also taken a step forward, through S&T management frameworks, to improve the way they review, assess and report on their S&T activities. Natural Resources Canada's efforts in this area are well under way; it started to implement its framework more than two years ago. Environment Canada recently published its own framework and is developing supporting documents. We encourage the other two departments to consider the same approach.

22.69 We found that progress in performance measurement has been slow except at Natural Resources Canada and, to a lesser extent, Environment Canada. As part of implementing their sustainable development strategies, most departments have developed a framework of performance measures. The next step, for those departments that have not yet done so, is to consider the benefits of building on this work by developing performance measures specifically for science activities.

Scientific excellence

22.70 The Strategy stated that the merits of a particular activity would be best confirmed through external review — an independent assessment of the design, performance and impact of a research effort. We found that all four departments have established or reorganized multidisciplinary advisory bodies. Most of them are expected to meet at least once or twice a year. Environment Canada has also created working groups drawn from its advisory committee members and employees to develop work plans for priority issues identified by the advisory committee. In our

opinion, the next step would be to monitor management's action on advisory committee recommendations. Some departments have already planned to do so.

22.71 While expert advice is sought for research planning, expert review of the science quality and impact of individual projects appears to be less common. As we did not audit the process of external review in the departments, we cannot comment on its effectiveness. However, we believe this is an important issue and will address it in our future work.

Partnerships

22.72 All departments work with partners to carry out many of their activities. The Strategy asked departments and agencies to seek more opportunities for partnership arrangements as a way to increase effectiveness. The Strategy commits them to develop strategies for promoting partnerships and S&T collaborative arrangements with industry, the provinces, universities and other stakeholders. Departments were also asked to develop strategies for increasing interdepartmental collaboration to combine resources and eliminate duplication.

22.73 In our view, this process would translate into clearly stated objectives and expected results to be pursued through external arrangements. We expected that departments would be able to describe and report the flow of financial or other resources to them, and between them and the external participants in the arrangements.

22.74 We found that progress has varied. Natural Resources Canada has made the most progress in setting out a strategy for partnership arrangements. In its public documents, it states specific objectives that it wants to achieve in partnership with all its stakeholders in order to meet each of its policy goals. Some of the sectors' business plans also state in more detail what they intend to achieve with their partners.

22.75 In 1997, Natural Resources Canada published a Framework for Revenue-Generation, External Funding and Collaborative Activities. The Framework is intended to, among other things, provide a set of common principles to guide decision making and implementation of new arrangements across the Department. Although the systems for gathering the information on its different revenue-generating activities are not yet fully in place, it appears that the Department will soon be in a position to report on its performance in these areas.

22.76 We noted that Agriculture and Agri-Food Canada has created the Matching Investment Initiative, which has proved to be a successful way of increasing the level of its collaborative research with industry. From our review of documents and our discussions with officials of Agriculture and Agri-Food Canada, we found that although the Department clearly stresses the need to work with partners in pursuit of objectives, it makes few references to what needs to be done and with whom.

22.77 Partnerships are an integral aspect of Environment Canada's S&T programs. We found that it has made efforts to demonstrate how its partnerships will help it to meet its objectives. It has also identified areas where partnerships need to be built or strengthened. In neither case, however, did we find specific strategies in place. The Department informed us that management was to have discussed strategic issues related to S&T partnerships over the summer of 1998. The Department is also drafting a guideline document on S&T partnerships as part of its S&T Management Framework. In our opinion, the document needs to contain guidelines for reporting on the Department's external partnership arrangements.

22.78 Recognizing that it is not yet systematically looking for partnering opportunities, Fisheries and Oceans is developing a Partnering Strategy as part of its Science 2005 Strategic Plan. It informed us that it has also begun to quantify the different types of external arrangements it has with its stakeholders.

Conclusion

22.79 As part of its S&T Strategy, the federal government committed itself to better managing its S&T activities. We looked at whether the government has made progress toward fulfilling its commitments to establish new institutions and mechanisms and to act on new operating principles for S&T, thereby placing the new management system on the solid foundation essential to it.

22.80 Although the government has acted on some specific commitments, the establishment of a revised management system has been slow. Much remains to be done to make it work well. Since changes take time, we were looking for signs that results were “just around the corner”. We found that S&T issues are getting attention at a higher level. However, we could not conclude clearly whether all the actions taken so far were attributable to a new way of doing business based on new mechanisms or simply to the initial momentum of the Strategy.

22.81 Whatever the explanation, the message remains the same: there are still significant challenges ahead because the government has not yet acted fully on its commitments under the Strategy. Two comments are warranted. First, it may be time for the government to clearly set out what remains to be done — what is next on the agenda. This would send a strong signal that the Strategy is alive and well and has its second wind.

22.82 Second, as we stated in 1994, leadership that transcends departmental mandates is essential to meet these challenges, especially if the progress to date has been due more to the initial momentum than to enduring change. In our opinion, the leadership shown so far in co-ordinating the S&T policy will not be sufficient in the future to address the remaining challenges. In fact, leadership will be a critical factor in ensuring that the current Strategy does not become simply one more missed opportunity.

22.83 In departments we found that although their progress in acting on the Strategy’s seven operating principles has varied considerably, even the less advanced have moved in the direction desired by the government. Overall, however, much more remains to be done, especially in reporting on performance.

22.84 The extent to which individual departments are improving the management of their science activities becomes less relevant, however, if they are not working together to better manage horizontal issues. Although we observed increased co-operation among departments, our case study on the horizontal issue of climate change science demonstrates that, in this particular case, departments are still carrying out science activities on the basis of their own priorities rather than common goals.

22.85 This has started to change, however. As part of the case study, we found that the proposed business plan for science activities under the Climate Change Action Fund appears to address the weaknesses we have identified in the government’s current approach to S&T in general. This and other recent initiatives lead us to believe that the experience in this area could lay a new foundation for the management of other horizontal issues.

Joint response of Agriculture and Agri-Food Canada, Environment Canada, Fisheries and Oceans, Industry Canada and Natural Resources Canada: A healthy federal science and technology community is essential to Canada’s economic, social and environmental well-being. The Federal Science and Technology (S&T) Strategy, delivered through each department’s mandate, is a blueprint for the direction and management of federal science and technology. We were pleased to note the Auditor General’s recognition of the fact that the application of the Strategy’s operating principles across departments varies according to their mandates. We welcome this follow-up as an indication of the priority that government places on the effectiveness of its S&T resources. While the data presented in the chapter are accurate, this response presents an opportunity to provide a context for the information as well as to highlight areas of continued progress since the audit was completed (note: this response speaks only for the five departments included in this follow-up.)

Departments have been working hard within their respective accountabilities and mandates to implement the Strategy, although the progress has been affected significantly by Program Review. In accomplishing this, and in support of the government's overall policy objectives, we welcome the support of the Minister of Industry in helping to achieve horizontal policy co-ordination on key issues. We feel it is essential to recognize that different parts of the federal S&T effort (e.g. advancing the frontiers of knowledge and mission-driven research) require different planning approaches. While the Strategy recognizes that federal S&T ministers must remain accountable for directing their departments' S&T efforts and resources toward fulfilling their mandates, we agree that some key files (e.g. climate change) do benefit from a horizontal management approach.

Our implementation of the Strategy continues and includes improving management of S&T human resources and building effective partnerships among levels of government and non-government stakeholders. Partnerships and collaborations include the interdepartmental S&T human resource initiative, the Climate Change Action Fund and the MOU on Science for Sustainable Development. The MOU itself has had a major impact in strengthening working relationships and increasing collaboration on key issues, such as climate change science, metals in the environment, nutrients and endocrine modulating substances. The success of the MOU will best be measured in the success of its individual projects, most of which are still in progress. The MOU was renewed in 1998 and was expanded to include Health Canada. The results of such co-operation and collaboration in S&T are becoming more evident as experience with these mechanisms and approaches grows. There are several other areas, such as Northern S&T and toxics substances research, where we are collectively just beginning to apply this experience. We feel that our efforts are having positive impacts and will continue to influence the co-ordination and co-operative management of federal S&T in the future.

About the Follow-up

Objective

Science and Technology for the New Century — A Federal Strategy is a policy statement that provides direction to departments and sets out the elements of a federal governance system for science and technology. Our objective in reviewing the Strategy was to assess the extent of progress made by the government in establishing new institutions and mechanisms for governance, and by departments in applying the operating principles set out in the Strategy.

Scope

We brought forward issues raised in our September 1996 Report Chapter 15 — Federal Science and Technology Activities: Follow-up.

We reviewed the commitments under the Strategy that are aimed at establishing new institutions and mechanisms for governance.

The Strategy outlines a framework of operating principles that provides direction to departments on how to manage their respective science programs. We reviewed the progress of selected departments (Agriculture and Agri-Food Canada, Environment Canada, Fisheries and Oceans and Natural Resources Canada) in applying these principles.

We prepared a case study whose purpose was to review whether the management of climate change science activities in the four selected departments reflects the principal commitments of the Strategy.

Approach

As called for in the Strategy, all major federal departments and agencies engaged in S&T prepared action plans detailing how they would put the Strategy into effect. We reviewed those action plans.

The federal government published a report titled *Minding Our Future, A Report on Federal Science and Technology — 1997*. Each department produced a summary report on its activities under the Strategy as input to *Minding Our Future*. We reviewed those summary reports.

We held interviews and discussions with officials involved in science and technology and reviewed relevant documentation.

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Chapter 23

Veterans Affairs Canada

Disability Pensions

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Veterans Affairs Canada

Disability Pensions

Main Points

23.1 The disability pension program has annual expenditures of about \$1.1 billion, making it the largest program of Veterans Affairs Canada. Disability pensions are paid to approximately 151,500 recipients — 68,000 veterans, 25,500 former or current peacetime members of the Canadian Forces and 58,000 survivors.

23.2 In September 1995, pension reform legislation came into effect. The legislation resulted in fundamental changes in responsibilities for the disability pension program. The Department took on new roles in providing assistance and counselling to disability pension applicants and in adjudicating first decisions for pension claims. The Veterans Review and Appeal Board was formed at that time to hear reviews and appeals of decisions.

23.3 The main focus of the disability pension program since pension reform has been on reducing the time it takes to make pension decisions. Veterans Affairs Canada and the Veterans Review and Appeal Board have exceeded their targets for reducing turnaround times for disability pension decisions.

23.4 The quality and consistency of the services provided in the preparation of first applications could be improved through greater use of standardized guidance materials and training for all those involved in the preparation of first applications. The table of disabilities, which is used in determining the nature and extent of disability for pension purposes, provides limited guidance for assessing the extent of some disabilities. To ensure consistent and high-quality disability pension decisions, the Department needs to improve its guidance materials that facilitate entitlement and assessment adjudications.

23.5 Veterans Affairs Canada does not provide reasons for assessment decisions. There is a need for the Department and the Veterans Review and Appeal Board to regularly analyze the reasons for overturned pension decisions.

23.6 Veterans Affairs Canada is not fully utilizing the departmental review process. This process was put in place by pension reform legislation and allows certain initial decisions to be reviewed more efficiently and in less time than a formal review request to the Veterans Review and Appeal Board.

23.7 Within the next 10 years, the mix of disability pensioners will change considerably, with a significant increase in the number of former or current peacetime members of the Canadian Forces. The Department needs to inform Parliament of the changes in its client base and the strategy for addressing those changes.

23.8 Veterans Affairs Canada has assigned a high priority to its Year 2000 projects. It has a plan and schedule that is expected to achieve Year 2000 compliance for its mission-critical systems by the end of 1998. However, the Department is also dependent on other systems for information, and disruption of those systems could affect the delivery of the disability pension program.

Introduction

Background and purpose of the disability pension program

23.9 In 1997-98, Veterans Affairs Canada spent about \$1.9 billion to provide veterans, qualified civilians and their families with the benefits, financial assistance and health care services to which they are entitled. Approximately \$1.1 billion of the total amount was spent on providing disability pensions to war veterans, members and former members of the Canadian Forces and survivors. The objective of the disability pension program is “to compensate veterans and other eligible clients in a timely and equitable manner for death or disabilities related to military service.”

23.10 Canada first began paying veterans pensions in 1917. After the Second World War, the veterans charter was established, giving veterans certain rights, privileges and benefits. The primary obligations undertaken by the government were the care and compensation of veterans who returned home wounded and disabled and the re-establishment of returning veterans into civilian life. The provision of disability pensions continues to be the largest single component of these ongoing obligations. In addition, the disability pension program is a gateway that provides eligibility to other programs provided by the Department, particularly health care benefits.

Responsibility for pension decisions

23.11 The Veterans Affairs Portfolio comprises Veterans Affairs Canada and the Veterans Review and Appeal Board.

23.12 The Department is responsible for counselling and assisting pension applicants, making the initial decisions on disability pensions, determining the amount of pension awards and administering the payment of awards. As well, the Department’s Bureau of Pension Advocates provides advocates to represent veterans and other eligible clients appearing before the Veterans Review and Appeal Board.

23.13 The Veterans Review and Appeal Board is an independent body reporting to Parliament through the Minister of Veterans Affairs. Board members are Governor in Council appointees. The Board is responsible for making decisions on reviews and appeals by applicants who are dissatisfied with pension decisions.

23.14 In 1997-98, the cost of delivering disability pension benefits was approximately \$29 million for the Department (including \$5 million for the Bureau of Pension Advocates) and \$8 million for the Veterans Review and Appeal Board.

The pension recipients

23.15 Veterans Affairs Canada administers disability pensions under the *Pension Act* to veterans of the First and Second World Wars and members of the Canadian Forces who served during peacetime, under the *Veterans Benefit Act* to veterans of the Korean conflict, and under the *Merchant Navy Veteran and Civilian War-related Benefits Act* to Merchant Navy veterans and qualified civilians. The Department also administers disability pensions to disabled peacekeepers as designated by the *Special Duty Area Pension Order*. In addition, it provides adjudication and counselling services, but does not pay pensions, on behalf of the Royal Canadian Mounted Police.

23.16 There are three major groups within the population of disability pensioners. The first group consists of veterans of the First and Second World Wars and the Korean conflict. This group of war service veterans has an average age approaching 78 years.

23.17 The second group of pension recipients consists of those who served in the Canadian Forces during peacetime, including those who served in Special Duty Areas. Special Duty Areas are usually associated with United Nations peacekeeping missions and are listed in Chapter 350 of the *Consolidated Regulations of Canada*. Peacetime pension recipients are generally younger than war veterans; most are under 65 years old. In conjunction with National Defence, initiatives are currently under way to improve service to these clients through better working arrangements and information exchange between the two departments. These initiatives are discussed further in paragraphs 23.78 and 23.79.

23.18 The third group of pension recipients includes survivors of pensioners. Survivor benefits are based on the pension that had been or would have been awarded to the pensioner prior to death.

23.19 Composition of clientele is changing. The total number of recipients of disability pension benefits has remained relatively constant over the past decade. In 1997-98, the Department provided pension benefits to a total of 151,500 recipients, consisting of 68,000 veterans, 25,500 current or former peacetime members of the Canadian Forces and 58,000 survivors. The composition of the clientele is shifting from war service disability pensioners toward survivors and peacetime disability pensioners. As shown in Exhibit 23.1, the Department estimates that by the year 2007, its disability pension clients will total about 145,000. Although this number is comparable with the current number, the mix of recipients will be significantly different, consisting of about 38,000 veterans, 41,000 former or current members of the Canadian Forces and 66,000 survivors.

Exhibit 23.1 is not available, see the Report.

23.20 In 1997-98, approximately 49 percent of new disability pension program clients were members or former members of the Canadian Forces who served in peacetime or personnel who served in a Special Duty Area. By the year 2006-07, the Department projects that this figure will rise to 60 percent. The number of applications for disability pension benefits received from this client group is a significant factor in the future of the Department, as the average age of these applicants is under 65 years. Exhibit 23.2 compares the age distribution of war service veterans and Canadian Forces disability pensioners.

Exhibit 23.1 is not available, see the Report.

Entitlement to disability benefits is determined by nature of service

23.21 The *Pension Act* incorporates two bases of entitlement to disability pension awards — the insurance principle and the compensation principle.

23.22 The insurance principle applies to clients with wartime service and includes peacekeepers who served in Special Duty Areas such as Haiti, Rwanda or the former Yugoslavia. Entitlement is granted on the basis of whether disability or death is attributable to, aggravated by or incurred during service. The government assumes complete responsibility for death, illness or injury 24 hours a day. Members of the Canadian Forces who qualify under the insurance principle, such as injured peacekeepers, can receive compensation while serving in the Canadian Forces.

23.23 For peacetime members of the Canadian Forces, entitlement to disability pension benefits is compensation for disabilities that are service-related. Currently serving members of the Canadian Forces may submit applications for disability pensions to Veterans Affairs Canada. For those eligible under the compensation principle, benefits commence upon discharge from the Canadian Forces. Benefits commence immediately for members of the Reserve Force who receive a favourable decision under the compensation principle. Exhibit 23.3 provides a summary comparison of the applicability of the insurance and the compensation principles.

Exhibit 23.3

Comparison of the Insurance and Compensation Principles in the *Pension Act*

<i>Pension Act</i>	Insurance Principle Subsection 21(1)	Compensation Principle Subsection 21(2)
Covers those who served in:	<ol style="list-style-type: none">1. Theatre of War<ul style="list-style-type: none">- World War I- World War II2. Theatre of Operations<ul style="list-style-type: none">- Korean Conflict3. Special Duty Areas	<ol style="list-style-type: none">1. Canadian Forces
Pension entitlement:	Conditions incurred during, aggravated by or attributable to time of service	Conditions that arose out of, were aggravated by or directly connected with military service during peacetime

Source: *Pension Act*, Part III - Pensions, subsections 21(1) and 21(2)

23.24 Disability pensions are awarded based on the extent to which a disability is related to service (entitlement) and on the nature and extent of the disability (assessment). Favourable entitlements for pension awards are rendered in fifths. Awards of one-fifth to four-fifths entitlement indicate that the disability is deemed to be partially service-related.

23.25 The pension legislation includes a long-standing “benefit of the doubt” provision. This provision requires, in making a decision, that every reasonable inference in favour of the applicant be drawn, that any uncontradicted evidence presented by the applicant that is credible in the circumstances be accepted, and that the decision resolve in favour of the applicant any reasonable doubt as to whether the applicant has established a case.

Assessing the extent of disability for pension awards

23.26 The basic concept established by the *Pension Act* in 1919 was that assessment of the disability of a pensioner was to be based on the extent to which the capacity for earning a living in the general labour market had been lessened. Today, under the *Pension Act*, “disability” means the loss or lessening of power to will and to do any normal mental or physical act.

23.27 A diagnosis and medical evidence are required to assess the nature and extent of disability for pension purposes. The *Pension Act* establishes the requirement for a table of disabilities to provide guidance to physicians and surgeons in assessing the extent of a disability.

Determining pension amounts

23.28 The determination of entitlement in fifths and the assessment of the extent of disability by percentage are combined to arrive at a disability percentage for the purpose of awarding a pension. Exhibit 23.4 shows the distribution of war service and Canadian Forces disability pensioners by percentage of disability.

Exhibit 23.4 is not available, see the Report.

23.29 Monthly pension rates are based on the extent of disability, marital status and number of eligible dependants. These benefits are not subject to personal income taxes and are not income-dependent. Exhibit 23.5

provides examples of the 1998 monthly disability pension rates. Survivor benefits are paid in proportion to the benefits that were being paid, or that would have been paid, to the disability pensioner at the time of death. One year following the date of death of the pensioner, disability pensions assessed at less than 48 percent are reduced by one half, while those assessed at 48 percent or more are converted to full survivors' pensions, which equates to 75 percent of the basic single pension.

Exhibit 23.5

Examples of Monthly Disability Pension Rates - Effective 1 January 1998

	Percentage of Disability					
	5%	15%	25%	35%	75%	100%
Single Pensioner	\$85.81	\$257.43	\$429.05	\$600.67	\$1,287.15	\$1,716.20
Married Pensioner	107.26	321.79	536.31	750.84	1,608.94	2,145.25
Pensioner, Spouse and Two Children	126.57	379.71	632.85	885.99	1,898.55	2,531.40
	Proportionate Rates					
	5%	15%	25%	35%	50 - 100%	
Surviving Spouse	\$53.63	\$160.89	\$268.16	\$375.42	\$1,287.15	

Source: *Pension Act*

Focus of the audit

23.30 Our audit focussed on the delivery of disability pension benefits by the Veterans Affairs Portfolio. We examined the adequacy of the management practices followed to ensure that high-quality pension decisions are made on a consistent basis and in a timely manner. We also examined the Department's progress in making its pension and allowance systems Year 2000-compliant. Details on the objectives, scope and criteria of this audit are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

Turnaround Times for Processing Pensions

Pension reform presented challenges

23.31 For many years, veterans and veterans' organizations expressed concern and frustration about the disability pension process. The process has been the subject of numerous studies, both inside and outside the Veterans Affairs Portfolio. Prior to September 1995, four separate entities were involved in the pension process: Veterans Affairs Canada, the Bureau of Pensions Advocates, the Canadian Pension Commission and the Veterans Appeal Board. Each entity was governed by its own legislation and was responsible for performing specific tasks within the process. The system was complex, with many players handling each claim. There were excessively long application-processing times, a large backlog of claims, a high incidence of appeals and a high percentage of decisions being overturned on appeal.

23.32 In September 1995, new and amended legislation was adopted to overhaul the application and appeals process for disability pensions. As part of this initiative, the government made a commitment to reduce turnaround

times for processing pensions by one half, over a two-year period, without affecting veterans' pension benefits or their right to appeal. The legislative amendments, also referred to as pension reform, resulted in the following changes:

- The authority to make first decisions on claims for disability pension benefits, previously the responsibility of the Canadian Pension Commission, was transferred to the Department.
- Responsibility for preparing first applications, previously a function of the Bureau of Pensions Advocates, was given to departmental officials in district offices.
- The Bureau of Pensions Advocates, previously a separate agency responsible for both the preparation of first applications and advocacy services for appeals, was merged with the Department and retained only the responsibility for providing advocacy services for reviews and appeals.
- The Canadian Pension Commission, which was previously responsible for first decisions and the first level of appeal, and the Veterans Appeal Board, previously responsible for the second level of appeal, were combined into the Veterans Review and Appeal Board to hear first-level and second-level appeals.

23.33 As a result of pension reform, the following procedures became the key steps of the pension decision-making process:

- Most applications are submitted through one of forty district offices or service centres across Canada. Assistance and counselling services are provided by district office or service centre personnel to applicants in preparing a complete disability pension application supported by service records, physician statements and medical evidence.
- Completed applications are submitted to the Department's head office, where adjudicators render entitlement and assessment decisions. Departmental medical advisors are available for consultation on entitlement decisions and, except for hearing loss claims, are consulted for all assessment decisions.
- If applicants are not satisfied with the first decision, they may request a departmental review upon presentation of new evidence or they may request the Veterans Review and Appeal Board to review the decision.

23.34 Pension reform resulted in significant challenges for all organizations involved in the pension process. For example, Veterans Affairs Canada faced the challenge of meeting the targeted reduction in turnaround times, while assuming its new role of assisting in the preparation of disability pension applications, making first decisions on disability pension claims and integrating the Bureau of Pension Advocates into the Department. The Veterans Review and Appeal Board was formed to fulfil the review and appeal roles previously provided by the Canadian Pension Commission and the Veterans Appeal Board.

September 1997 turnaround time targets have been exceeded

23.35 Turnaround time has been the key performance indicator for measuring the progress of the Veterans Affairs Portfolio in achieving its pension reform commitments. For this purpose, turnaround time is defined as the time from the date an applicant indicates an intention to apply for a pension, or appeal a previous decision, to the date the award is processed for payment. Unfavourable decisions are not included in the turnaround times. In Chapter 12 of our May 1996 Report to Parliament, we reported on our examination of the first application turnaround times reported by the Department prior to pension reform. We also reviewed the turnaround times reported for reviews and appeals.

23.36 The Veterans Affairs Portfolio has achieved significant reductions in turnaround times for processing pensions, and has exceeded its targets for September 1997. The reduction in turnaround times has been achieved through a simplified organizational structure that resulted in fewer steps to reach decisions. The most significant

reductions have occurred in the time for preparing first applications and for preparing cases for review and appeal hearings.

23.37 We verified turnaround times reported for September 1997. Our examination was based on a detailed review and compilation of turnaround times for a statistical sample of claims adjudicated during the period July to December 1997. From this examination, we determined that the information contained in the Pension Status and Inquiry System is accurate for the purposes of compiling turnaround time statistics. Exhibit 23.6 shows significant improvements in turnaround times for each type of claim.

Exhibit 23.6 is not available, see the Report.

23.38 The turnaround times reported by the Department are average turnaround times for each claim type. The distribution of turnaround times for first applications before and after pension reform are compared in Exhibit 23.7. As shown, the average turnaround time has decreased from 18 months to 5.4 months and the variability in turnaround times has decreased significantly. In other words, since pension reform, average turnaround time as a performance indicator has become more reliable because the actual turnaround times are more closely grouped around the average. Pension claims are processed in less time and in a more predictable amount of time. Such information is useful for operational planning, accountability and development of service standards.

Exhibit 23.7 is not available, see the Report.

Service standards

23.39 In June 1998, the Veterans Affairs Portfolio published a client information brochure entitled *Veterans Affairs – At Your Service*, outlining the quality of service that can be expected by clients. Such commitments to service are important elements of an accountability framework. The Department has established a service standard of 18 weeks (4.1 months) for reaching a decision once a completed first application has been received.

23.40 During 1997-98, the Department received approximately 14,000 first applications for pension benefits. A first application is the first time that an applicant applies to receive a disability pension for a medical condition. It does not include requests to reassess existing pensioned conditions.

23.41 The Department's role in the pension application process includes providing assistance and counselling to applicants in preparing applications, obtaining information in support of the application, requesting and reviewing service records and obtaining current medical information. Exhibit 23.8 shows the distribution of turnaround times for the period January to June 1998. These turnaround times include all activities from the time an application is initiated to the time payment is requested. We noted during our audit that the process for preparing applications represented approximately one half of the turnaround time. Consequently, given the significant amount of time to prepare an application, and the role played by the Department in this step, we would expect that this part of the process would also be covered by a service standard.

Exhibit 23.8 is not available, see the Report.

23.42 **Veterans Affairs Canada should develop service standards for the Department's role in preparing a first application for disability pension benefits.**

Department's response: The Department agrees and therefore included such standards in its 1998 brochure "Veterans Affairs At Your Service" in the sections "Meeting Your Needs" and "Information and Advice". More specifically, in the section on "Disability Pension Application", we also state: "If you contact us about a service-related disability pension, we will help you prepare your application, help you obtain information in support of your

application, answer your questions, research your records and assist you to obtain current medical information.” We intend to survey our clients on the quality and effectiveness of these services.

Veterans Affairs Canada chose not to include service standards about the time to carry out these services because most of the activities involved in case preparation lie outside the Department’s control, either with outside agencies or clients themselves. The service standard brochure was the subject of consultation with the Department’s clients and client groups who agreed that time standards for case preparation were of lesser significance than those we chose to include on decision making and medical exams.

Making Pension Decisions

Preparing the disability pension application

23.43 The role of the pension officers is to provide counselling services to applicants and to assist them in preparing applications for disability pension benefits. The quality and completeness of the application is important in obtaining the right pension decision the first time. High-quality first applications include complete and accurate information for each medical condition claimed, and are supported by appropriate service documents, medical records and physicians’ statements.

23.44 The Department has developed a standard set of application forms for disability pension benefits. When completed, the application package should provide details of each medical condition claimed and its claimed relationship to the applicant’s service.

23.45 We found inconsistencies in the level and nature of the services provided by the Department in counselling applicants. For example, in some offices, we noted that counselling was provided to applicants in identifying service-related disabilities other than those initially put forth by the applicants. In other instances, we found that the focus was limited to the conditions identified by the applicants.

23.46 The Department provided national and regional training throughout the pension reform process. However, the Department does not have a formal training policy for the disability pension program and we noted that some pension officers have not yet received formal training.

23.47 We also noted that the working tools used to assist in the preparation of first applications, including medical guidance materials and questionnaires, vary from office to office.

23.48 We concluded that there are opportunities to improve the consistency and quality of the services provided to applicants in the preparation of disability pension applications. By improving and implementing standardized policies, practices and procedures, the Department can obtain greater assurance that disability pension applications are completely and accurately prepared and include the appropriate supporting evidence.

23.49 The number of applications completed by each pension officer varies widely, depending on the nature of the claims. For example, hearing loss claims are more straightforward to process, compared with claims involving complex or multiple conditions, such as orthopedic injuries, which can be very difficult and time-consuming. In addition, the mix of clientele can be quite different from one district to another. For instance, nationally, the Canadian Forces members represented 45 percent of first applications in 1997-98. However, in some district offices, Canadian Forces members accounted for up to 70 percent of first applications. The service documents for Canadian Forces members tend to be quite extensive, requiring more time to review than a typical war service veteran’s file. To ensure that the needs of claimants are met in an efficient and timely manner, the Department needs to review its distribution of work related to the preparation of first applications to determine where resources should be allocated.

23.50 Veterans Affairs Canada should improve the services provided to applicants in the preparation of disability pension applications by:

- improving standard national guidance materials and manuals;
- ensuring that new pension officers receive appropriate initial training on a timely basis; and
- re-examining workload distribution.

Department's response: The Department is committed to the pursuit of the highest standards of counselling and assistance to applicants in the preparation of disability pension applications and to the provision of timely and effective training to pension officers.

Work is under way to develop both a standardized information and procedures manual for use by field staff and a training module for pension officers to support the first application process.

The Department agrees that workload distribution is an important consideration for effective resource utilization and will continue to actively address this issue. This will be done, in part, through its ongoing Workload Standards project and through medium- and long-term human resource planning based on employee demographic and client forecasts.

Adjudication of first applications

23.51 First decision process. Adjudicators at Head Office in Charlottetown, who have health sciences or nursing backgrounds, make first decisions on disability pension claims. Departmental medical advisors are available for consultation on issues relating to entitlement and, except for hearing loss claims, are consulted for all assessment decisions. The first decision process includes a determination of an applicant's entitlement and an assessment of the extent of disability for pension purposes.

23.52 As illustrated in Exhibit 23.9, three key questions are addressed in the first decision process:

- Is there a medical disability?
- Does the disability relate to service?
- What is the extent of the disability?

Exhibit 23.9 is not available, see the Report.

23.53 As part of the first application, the applicant must specify the medical condition that is the basis for the claim and submit medical evidence to support the application. The adjudicator uses this information to determine if there is a medical disability.

23.54 The application must also be supported by service records. The adjudicator uses this information to determine if the disability relates to service. This is the entitlement decision. For certain medical conditions and service-related activities, the Department does have guidance materials to assist adjudicators in making entitlement decisions. General guidelines have been developed to assist in determining entitlement for certain common claims, including hearing loss and orthopedic conditions; however, for most other conditions, the guidance to link medical conditions to service needs to be improved.

23.55 Table of disabilities. The primary decision-making guidance material for assessing the extent of medical disability for pension purposes is the table of disabilities. Other guidance in the form of memoranda and directives has been provided on an ad hoc basis by medical advisors. This material assists in assessing the extent of disability for pension purposes and in performing pension medical examinations. Prior to pension reform, the table of disabilities was the responsibility of the Canadian Pension Commission. Since September 1995, the table has been the Department's responsibility.

23.56 The table of disabilities provides descriptions of various medical conditions and diseases, which are used in determining the percentage of disability for pension purposes. It was designed primarily as an aid to physicians, making it difficult for adjudicators to use in making assessment decisions. For hearing loss claims, the Veterans Affairs Portfolio has developed guidance materials to determine the extent of disability for pension purposes. For other conditions, we found a lack of guidance material to link the medical condition claimed to the percentage of disability for pension purposes. Therefore, except for hearing loss claims, medical advisors are consulted in the assessment of claims. This practice highlights the need for additional guidance materials to support the table of disabilities. For example, in the case of an osteoarthritis hip condition, the table of disabilities provides only the following limited guidance:

- mild — 10-25 percent;
- moderate — 25-35 percent; and
- severe — 35-50 percent.

23.57 The table could be improved by expanding its scope and providing detailed criteria for assessing the extent of disability. These improvements would ensure greater consistency in making assessment decisions.

23.58 Information on all pension claims is recorded in the Department's Pension Status and Inquiry System. The Department's Pension Disease Classification Manual provides a standard coding structure for coding medical conditions in this system. In Canada, this coding structure is unique to Veterans Affairs Canada.

23.59 Interim assessments. Interim assessment decisions are rendered when, at the time of adjudication, there is sufficient information to establish entitlement to disability pension benefits but there is not sufficient information to assess the level of disability unconditionally. Interim assessments result in applicants receiving a pension award faster.

23.60 In the sample of claims we reviewed, we noted that approximately one third of favourable first applications during the period July to December 1997 were processed into payment using interim assessments. Based on departmental data, we calculated that it took an average of 3.5 months to schedule and complete a final assessment in cases where an interim assessment had been made.

23.61 We noted that the Department does not have a written rationale for the level of assessment determined for individual claims, such as the relevant information that was reviewed, the key factors analyzed or the degree of consideration given the various factors in rendering an assessment decision. Such documentation would facilitate review and would be useful in determining trends in decisions overturned on review and appeal. Decisions rendered by Veterans Affairs Canada are communicated to applicants in decision letters. These letters do not provide any explanation for the assessment of the level of disability.

23.62 Veterans Affairs Canada should improve guidance materials to be used in making entitlement decisions and in assessing the extent of disability for pension purposes. The guidance materials should be revised periodically to reflect the trends of disability pension claims.

23.63 The Department should document the reasons for assessment decisions and provide these reasons to applicants.

Department's response: The Department agrees. Efforts are under way to address these concerns through improvements to the Department's Table of Disabilities and Medical Guidelines. These improvements should in turn enable the Department to better articulate the reasons for assessment adjudications for the benefit of applicants and pensioners.

Review and appeal process

23.64 The claims adjudication process seeks to provide applicants with every opportunity to establish their claims and to obtain disability pension benefits. The review and appeal process allows each claim several adjudications.

23.65 As previously described, the Department's officials make the decision on a first application for disability pension benefits. The results of a first decision are conveyed to applicants in a decision letter. If applicants are not satisfied with this first decision, they may notify the Department that they disagree. The *Pension Act* provides that the Department may, on its own motion, review a pension decision where it appears there was an error in a finding of fact or law. In addition, upon presentation of new evidence, clients may request a departmental review.

23.66 If applicants are not satisfied with the results of the first decision or departmental review, they may request a review by the Veterans Review and Appeal Board. After a review of the facts, the Board may send a case back to the Department, may hold a review hearing or may in certain circumstances refuse to hear the case.

23.67 If a review hearing is scheduled, applicants have the right to appear before the Review Panel where they are usually represented by an advocate from the Bureau of Pension Advocates. The advocate represents the applicant throughout the review and appeal process without charge.

23.68 If applicants are not satisfied with the decision made by the Review Panel, they may appeal the decision to an Appeal Panel of the Veterans Review and Appeal Board. Only documentary evidence may be submitted at this stage, and it is usually presented to the Appeal Panel by an advocate on behalf of the applicant.

23.69 Exhibit 23.10 shows the outcome of a sample of 126 first applications examined during our audit. Fifty-seven applications received favourable rulings at the first decision level, nine received favourable rulings at the Veterans Review and Appeal Board review level and four more received favourable rulings at the Board appeal level. At the first decision and Board review levels, a favourable ruling is defined as a ruling that is both favourable and acceptable to the applicant.

Exhibit 23.10 is not available, see the Report.

23.70 In our sample, we found that 54 percent of applicants who were dissatisfied with the rulings at the first level had the decision reviewed by the Board's Review Panel. We also found that 83 percent of unfavourable or unsatisfactory Board Review Panel decisions went to an appeal hearing. As noted in the exhibit, these figures are conservative, as additional favourable decisions may be rendered with the passage of time. There is no time limit within which an applicant must request a review or an appeal of a pension decision. Of the 37 claims appealed to the Board's Review Panel, 13 claims, or 35 percent, were overturned at the review or appeal levels.

23.71 During our review of Veterans Review and Appeal Board decisions and of analyses performed by the Department, we noted several reasons for decisions being overturned on review or appeal. Examples include the application of the "benefit of the doubt" provision of the *Pension Act*, the introduction of additional evidence (including oral testimony of the applicant at the review level) and different interpretations of the law, especially in matters of entitlement. In some cases, the reasons given by the Board for overturning departmental decisions were

not fully articulated. At the Veterans Affairs Portfolio level, systematic analysis of decisions, based on clearly documented reasons for the decisions, could provide opportunities to improve the pension decision-making process.

23.72 In order to improve the quality and efficiency of decision making, the Veterans Affairs Portfolio should carry out regular analyses of the reasons for decisions that are overturned by the Veterans Review and Appeal Board.

Department's response: The Department is committed to the provision of high-quality, consistent and timely decisions. We have previously conducted analyses of the reasons for decisions of the Veterans Review and Appeal Board. We will continue to do so on a regular basis in the future.

Veterans Review and Appeal Board response: Agree. As has been the case since its creation, the Board continues its commitment to quality and the continuous production of fully articulated decisions. To achieve this goal, the Board will continue to provide intensive training to its members on all aspects of the adjudicative process, including the legislation, medical and legal issues, the conduct of a hearing and decision writing. Quality assurance is a priority for Board staff and members.

23.73 As described in paragraph 23.65, one of the legislative amendments effected under pension reform was Section 82 of the *Pension Act*, dealing with departmental review. This review process, which can be used for certain cases such as an error in fact or the presentation of new evidence, is quicker and less costly than the Veterans Review and Appeal Board process. In addition, it does not require the applicant to forfeit any right to review or appeal a decision to the Board. The Department has made a commitment to render a decision on a departmental review within four weeks. The average turnaround time for reviews heard by the Veterans Review and Appeal Board is approximately four months.

23.74 During our examination, we noted that for 3 of the 23 Board reviews and appeals we examined, additional evidence was submitted and formed the basis for overturning the previous decision. In addition, our review of departmental data shows that the average number of departmental reviews per month has fallen from 45 in 1997-98 to 26 for the first five months of 1998-99.

23.75 To improve the efficiency and timeliness of decision making in the disability pension program, Veterans Affairs Canada should examine opportunities to make greater use of the departmental review process.

Department's response: The Department is pursuing various means of improving the efficiency and timeliness of decision making for the disability pension program. It is agreed that in certain circumstances, use of the departmental review process could be exploited further. The Department will undertake to clarify and to communicate appropriate use of this tool.

The Changing Nature of the Department's Clients

23.76 Most Canadians would be interested to know that Veterans Affairs Canada continues to spend over \$1 billion annually on veterans' disability pensions. While pension expenditures have been relatively stable, the recipients of pensions have changed considerably. Today, the majority of recipients are either former or current peacetime members of the Canadian Forces or survivors (Exhibit 23.1).

23.77 The Department has estimated that within 10 years, war service veterans will form the smallest group of disability pensioners. The largest client group of disability pension recipients will be survivors, followed by former or current peacetime members of the Canadian Forces. As shown in Exhibit 23.2, Canadian Forces disability

pension clients are much younger than war service clients. As the pensioner population changes, it is important that the Department consider options for delivering services to clients efficiently and economically.

23.78 Veterans Affairs Canada and National Defence have recognized the increasing prevalence of peacetime members of the Canadian Forces as clients of Veterans Affairs. The departments have been working together to enhance communication, to develop a closer relationship between the two departments and to improve Canadian Forces members' access to Veterans Affairs Canada services and benefits.

23.79 A Veterans Affairs–Canadian Forces co–ordination team has been established within Veterans Affairs Canada. This team was formed to provide a central co–ordination point in the Department for all matters concerning Veterans Affairs Canada and National Defence, to identify issues of mutual concern between both departments, to facilitate action and to monitor progress on improvement initiatives between the two departments. Each department has appointed a liaison officer to be part of an exchange program that will further enhance co–operative working arrangements.

23.80 We reviewed Veterans Affairs Canada's 1998-99 Report on Plans and Priorities, tabled as part of the Estimates. The document makes little mention of the Department's role in relation to the peacetime members of the Canadian Forces or how the Department will change to fulfil this increasingly important role in the future. We expected that Veterans Affairs Canada would use this key accountability document to explain the changing nature of clients and the strategy for adapting to the changes.

23.81 In reporting to Parliament through its Report on Plans and Priorities, Veterans Affairs Canada should explain the role it plays in relation to the peacetime members of the Canadian Forces, the changes expected in its client base and its strategy for adapting to these changes.

Department's response: Veterans Affairs Canada is currently analyzing the medium– to long–term changes of its client base, including Canadian peacetime forces. The 1999-2000 Report on Plans and Priorities will report on the Department's role concerning peacetime forces as well as on an approach to address these changes.

Year 2000 Compliance

Year 2000 compliance is a departmental priority

23.82 The Year 2000 problem stems from the long–established practice of entering, storing, calculating and reporting dates in a six–digit format reflecting year/month/day. This practice began in the 1950s and 1960s to save computer data storage space, which at the time was limited and expensive. Many systems today still use six–digit date formats where the year is in a two–digit format. In such systems, the year 1998 is represented as “98” and the year 2000 as “00”. However, a two–digit year code of “00” may be interpreted by systems as the year 1900 or a “beginning of time” date, such as the date the system was implemented. Such erroneous interpretations of year 2000 dates can lead to serious problems in systems that use dates for labelling, sorting, updating and other data manipulations involving dates.

23.83 Many of the Department's systems use a six–digit date format. Dates are used extensively for important calculations. For example, the effective date of a disability pension award is used to calculate the payment amount. An incorrect interpretation of a year 2000 effective date could have a serious impact on payment calculations. A failure of any of the Department's mission–critical systems could affect many Canadians since the systems provide a major source of income and access to services and benefits.

23.84 In 1996, the Department initiated a Year 2000 project. The Treasury Board Secretariat has identified the Department's health care systems and the pension and allowance systems as government–wide mission–critical

systems. The Secretariat is closely monitoring progress toward Year 2000 compliance for all such systems. The Department is also tracking its Financial Management Information System as a mission-critical system because of its importance for administrative and financial control. We reviewed the Department's actions to make the pension and allowance systems Year 2000-compliant.

23.85 One of the departmental business renewal initiatives currently under way is the Benefits Redesign Project. As part of this initiative, a new Client Service Delivery Network system is being implemented. This system is designed to be Year 2000-compliant. Since the original planned implementation date of 1999 was too late for full resolution of Year 2000-related problems, the project was rescope and rescheduled to be the primary Year 2000 system. In addition, the Department has adopted a strategy of converting existing systems as a contingency to ensure Year 2000 compliance while implementing the new business renewal systems.

Work on mission-critical systems is well under way

23.86 The Department recognizes that the Year 2000 deadline cannot be changed and that project slippage could result in systems failure. Detailed progress on all project elements is regularly monitored and compared against the project schedule. As of July 1998, the project schedule and progress to date indicated that the Department's government-wide mission-critical systems would be Year 2000-compliant by December 1998. At the time of our audit, the Year 2000-compliant allowance system was operating and the pension system was being user tested.

23.87 Implementation of the Client Service Delivery Network is planned to occur in phases, with the first release planned for December 1998 and the second release planned for March 1999. Through various initiatives, the Department has been able to secure adequate staff resources to carry out projects related to Year 2000 compliance. Project funding has also been secured. Total project costs, estimated as of July 1998, are \$51 million for the Veterans Affairs Portfolio's systems.

Dependency on non-departmental systems

23.88 As is common with other organizations, the proper functioning of the Department's systems requires exchanges of information with several external systems. These interfaces expose the Department to risks beyond its control because it is dependent on external parties to perform certain tasks to ensure Year 2000 compliance. The Department's risk assessment indicates that it should be able to deliver services to clients even if these interfaces fail. At the end of our field work, testing of all but one of the interfaces had been scheduled. Negotiations were ongoing to ensure Year 2000 compliance of the remaining interface.

23.89 As of July 1998, the Department was beginning an assessment of its facilities and embedded systems to determine the extent to which they may be affected by the Year 2000 problem. Embedded systems consist of hardware and software that form a component of some larger system and are intended to operate without human intervention. These systems and facilities include, among others, telecommunications systems, building maintenance and energy management systems and security systems.

23.90 The assessment was to be completed by the fall of 1998, with the majority of the required remedial expenditures to occur in 1999. The Department is working in conjunction with Public Works and Government Services Canada (PWGSC), Health Canada and other government departments on the compliance issues related to embedded systems. At the completion of our field work, the Department was surveying regional and district offices in co-ordination with PWGSC to develop an inventory of affected systems.

23.91 The Department has developed an appropriate plan and is working toward resolving the Year 2000 problem in its government-wide mission-critical systems. We believe that the Department is appropriately managing the risks of the problem. However, because of embedded systems, facilities and the interaction of departmental systems with other government and non-government systems, it is impossible to give assurance that the Department will not

suffer some effects from the Year 2000 problem. The Department is now beginning to address concerns about systems that are not mission-critical but could affect operations.

Conclusion

23.92 The Veterans Affairs Portfolio has been successful in meeting its commitment to significantly reduce turnaround times for processing pensions. It now needs to continue to enhance this process by taking the steps necessary to improve the consistency, efficiency and overall quality of disability pension decisions.

About the Audit

Objective

The objective of our audit was to determine whether the Veterans Affairs Portfolio (Veterans Affairs Canada and the Veterans Review and Appeal Board) is managing the disability pension program in a manner that ensures that high-quality disability pension decisions are made on a consistent basis and in a timely manner.

Scope

Our audit focussed on how the disability pension program is managed to achieve the legislated objectives of providing benefits to veterans and other eligible clients. We also examined the Department's progress in making its pension and allowance systems Year 2000-compliant.

Criteria

We expected that:

- Veterans Affairs Canada would have the means to ensure that high-quality disability pension decisions are made to consistently reflect the requirements and intent of governing legislation;
- the Veterans Affairs Portfolio would collect and report accurate, relevant and reliable information on the length of time taken to reach decisions on disability pensions; and
- the Veterans Affairs Portfolio would have made sufficient progress against its Year 2000 plan to ensure that concerns that could affect the timely processing of pensions have been addressed.

Audit Team

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Chapter 24

Revenue Canada

International Tax Directorate Human Resource Management

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Revenue Canada

International Tax Directorate Human Resource Management

Main Points

24.1 Revenue Canada's International Tax Directorate was established in November 1991. It is the focal point for all international tax issues (except legislative issues), with a view to enabling Revenue Canada to respond to them in a consistent and timely way.

24.2 A recent report of the Technical Committee on Business Taxation noted the following:

- In 1993, taxpayers reported to Revenue Canada \$248 billion in related-party cross-border transactions, \$166 billion of which were between related parties in Canada and the United States.
- In 1995, foreign direct investment into Canada was approximately \$170 billion, or 20 percent of assets held by Canadian businesses; and outbound foreign direct investment by Canadians was about \$140 billion, or 18 percent of total assets held by Canadian businesses.
- Even relatively small shifts in income allocated to Canada from related-party transactions have the potential to cause a significant change in the domestic revenue base.

24.3 In this complex and growing field, the Directorate requires staff who are highly skilled and who understand Canadian tax laws and tax laws in other jurisdictions.

24.4 Weaknesses in human resource management in the Directorate, coupled with the often cumbersome human resource management rules in the public service, have resulted in long delays in the competition process for staffing positions and in finalizing appointments. Skilled candidates for international tax positions at senior levels are rare, and are in demand in the private sector. Good candidates may lose interest if they have to wait long periods before being offered a position.

24.5 Currently, key positions in the Directorate — including positions of leadership — are filled by using secondments, redeployments and acting assignments. We are concerned that this approach to staffing may result in a lack of continuity and stability and may pose a risk to both the quality of work performed and the Directorate's ability to fully realize potential revenues and protect Canada's tax base.

24.6 Despite having recognized since 1994 the urgent need for a human resource plan, the Directorate is still developing a comprehensive human resource plan and strategies linked to its business plan. During September and October 1998 it initiated a number of actions that, upon completion, it expects will address certain identified problems.

24.7 Existing human resource and performance data bases need to be enhanced and better used to provide managers with information needed for human resource planning.

24.8 If Parliament approves the establishment of the proposed new Canada Customs and Revenue Agency, the Department will become a separate employer and assume most of the responsibility for human resource management. In the absence of a comprehensive human resource plan and strategies linked to the Directorate's business plan, the establishment of the new agency will not in itself resolve the problems outlined in this chapter. It is important that the analysis, planning and implementation of needed human resource initiatives be carried out as soon as possible to ensure that the Directorate can appropriately manage the risks to Canada's tax base that are inherent in international transactions.

Introduction

International tax is a complex and growing field

24.9 Revenue Canada's International Tax Directorate was established in November 1991. It is the focal point for all international tax issues (except legislative issues), with a view to enabling Revenue Canada to respond to them in a consistent and timely way.

24.10 The Department realigned its international tax resources in response to changes in the international environment. Those changes included the removal of trade barriers as a result of international agreements (such as free trade agreements and GATT — General Agreement on Tariffs and Trade); economic union of the European Community and social and political changes in various parts of the world; the growing complexity of international financial transactions; the rising use of tax havens; the increasing number of bilateral income tax treaties and agreements; and the aggressive stance of some of Canada's trading partners.

24.11 The Directorate develops and refines tax administration programs and systems to ensure compliance with the legislation that applies to non-residents and international transactions. It also provides policy guidance and technical assistance on international tax issues.

24.12 For 1996-97 Revenue Canada reported that its international tax programs generated total recoveries of \$630 million.

24.13 The Directorate includes four divisions: International Audit; Non-Resident Assessing and Withholding; Transfer Pricing and Competent Authority; and International Tax Strategy. Exhibit 24.1 shows how the Directorate's staff are deployed throughout Revenue Canada and summarizes the responsibilities of its four divisions.

Exhibit 24.1 is not available, see the Report.

24.14 The Directorate is responsible for identifying the resources needed to deliver its programs, and for identifying the staff it needs for its functions at Revenue Canada's headquarters. Tax Services Offices (TSOs) are responsible for staffing their own international tax audit positions, using guidelines prepared by the Directorate at headquarters. The Department's human resource personnel at headquarters and at TSOs carry out the identified staffing actions.

24.15 The International Tax Directorate has taken a number of initiatives to manage risk to the tax base. Some of these initiatives are:

- introducing measures to enhance the reporting of world income;
- strengthening, in partnership with the Department of Finance, key legislation in the areas of, for example, transfer pricing, foreign affiliates and disposition of taxable Canadian property;
- addressing the tax implications of electronic commerce in international forums;
- working with Canada's treaty partners to enhance specific compliance activities such as the exchange of information, simultaneous audits, advance pricing agreements, and the examination of tax haven issues.

Focus of the audit

24.16 This audit focussed on human resource management in the International Tax Directorate. Our objective was to determine whether human resource management practices are sufficient to enable the Directorate to manage the inherent risk to Canada's tax base caused by international transactions. Subsequent audits will focus on international tax compliance activities.

24.17 The International Tax Directorate is part of the much larger Verification, Enforcement and Compliance Research Branch in the still larger departmental structure. This has certain implications for human resource management, which we took into account in our audit:

- Most human resource policies are determined by central agencies and implemented by the Department. This affects the Directorate's flexibility to address staffing issues.
- The Branch influences the Directorate's vision and the scope of its activities, along with its resourcing; the assignment of resources depends on the Branch as well as the Department. The level of resources they allocate to the Directorate will reflect the priority they attach to its activities, as well as the other pressures and challenges being faced by the Department and government.

24.18 Further information on our objectives, scope and criteria can be found at the end of the chapter in the section **About the Audit**.

Observations

International Transactions Have the Potential to Erode the Tax Base

24.19 International tax is a growing field with significant potential for tax revenues. In this complicated, knowledge-intensive area, the International Tax Directorate requires a stable work force of highly skilled people. The complexity of its work is reflected in the types of transactions, industries, and policy questions that define its scope — transfer pricing; electronic commerce; non-residents doing business in Canada or disposing of taxable Canadian property; global enterprises and their related-party transactions; tax havens and harmful tax competition; international financing arrangements; and international tax treaties.

24.20 A recent report of the Technical Committee on Business Taxation noted that in 1993, taxpayers reported to Revenue Canada \$248 billion in related-party cross-border transactions, \$166 billion of which were between related parties in Canada and the United States. As the report went on to note, considering that in 1996 Canada raised close to \$20 billion in federal and provincial corporate income tax, even relatively small shifts in income allocated to Canada from related-party transactions have the potential to cause a significant change in the domestic revenue base.

24.21 The report also noted that foreign direct investment into Canada is substantial, in 1995 amounting to approximately \$170 billion or 20 percent of assets held by Canadian businesses. Outbound foreign direct investment by Canadians is also significant — in 1995 about \$140 billion or 18 percent of total assets held by Canadian businesses — and is rising faster than inbound investment.

24.22 Therefore, the complexity and significance of international tax issues demand that Revenue Canada attract, motivate and retain well-qualified and trained staff who can perform effectively and to a high standard. Its international tax employees must be highly skilled and understand Canadian tax laws and tax laws in other jurisdictions.

24.23 Exhibits 24.2 and 24.3 set out the Directorate's staff resources at the Department's headquarters and at Tax Services Offices across the country.

Exhibit 24.2

Directorate's Staff Resources at Headquarters, August 1998

	Permanent in Position	On Loan from Another Directorate	Acting Assignment and on Loan from Another Directorate	Total
Director General's Office	3	4	-	7
International Audit	11	1	8	20
Transfer Pricing and Competent Authority	14	4	6	24
Non-Resident Assessing and Withholding	11	3	10	24
International Tax Strategy	3	-	2	5
Total	42	12	26	80

Source: Revenue Canada

Exhibit 24.3

Directorate's Staff Resources at Tax Services Offices, August 1998

Region	Permanent in Position	On Loan from Another Directorate	Total
Atlantic	18.5	1.0	19.5
Quebec	59.5	9.0	68.5
Northern Ontario	24.5	-	24.5
Southern Ontario	145.5	12.0	157.5
Prairie	36.5	29.0	65.5
Pacific	60.5	-	60.5
Total	345.0	51.0	396.0

Note: Figures do not include staff at the International Tax Services Office.

Source: Revenue Canada

Stable Leadership Is Required

24.24 In September 1996, the Director General of the Directorate was transferred to another branch of the Department. A staffing action was undertaken shortly thereafter and the current Director General was appointed in October 1997 — one year later. In the interim, the four Division Directors reported directly to the Assistant Deputy Minister.

24.25 Other key positions have been filled through the use of secondments, redeployments and acting assignments. As of October 1998, three of the four Divisions have as Directors staff who are acting in the positions at a level higher than their own classification level and who are on loan from another work location. The Director of the fourth Division is also on loan from another work location. The acting Directors had advised their staff in February 1997 that they would continue in an interim capacity to allow a new Director General to decide who would hold the positions on a permanent basis.

24.26 We are concerned that in such a situation of uncertainty about whether they will remain in their positions, people may focus on the routine, day-to-day issues and not pay appropriate attention to important long-term planning or make critical decisions about it.

Frequent Staff Movements Are a Cause for Concern

24.27 All functions at headquarters are important in providing overall direction and technical expertise for the Directorate's activities. Therefore, staffing problems at headquarters could have a negative impact on international tax work done in the TSOs.

24.28 Only 52 percent of the Directorate staff at Revenue Canada headquarters are in their permanent positions, including only 20 of the 32 senior auditors. In the Transfer Pricing and Competent Authority Division, 60 percent of the present staff are in permanent positions. This Division expects to triple its present work force within the next seven months.

24.29 We found that the movement of the Directorate's staff at headquarters was high. At 1 April 1995, there were 58 employees at headquarters, 31 of whom are still there. At various times over the 40 months from April 1995 to September 1998, 66 people left and had to be replaced and 22 more people joined the Directorate's headquarters staff. It currently has 80 employees at headquarters. The Department informed us that 33 percent of the staff who left had been brought in specifically for short-term projects or for developmental assignments.

24.30 In TSOs, 87 percent of the international tax employees are in their positions on a permanent basis. However, only 68 percent of the senior international tax auditors are permanent in the positions. TSO auditors in general have an average of less than three years' experience in international taxation.

24.31 Because of the complexity and the significance of international tax issues, we are concerned that frequent staff movements may prevent the Directorate from maintaining the experience and skill levels required to provide an appropriate level of service to taxpayers and to manage the risks to the tax base that are inherent in international transactions.

The Directorate Could Take Action to Speed Up the Staffing Process

24.32 Information on recent competitions for positions in the Directorate highlights the time it takes to complete a staffing action:

- A competition for program managers closed in April 1997; in October 1998 the examinations were being marked — 18 months after the competition closed.
- A competition for senior international officer positions closed in August 1997; the results were issued in September 1998.
- A competition for international officer positions closed in October 1997; the examinations were being marked in October 1998, one year later.
- A competition for international tax advisor positions closed in October 1996; the eligibility list was established 18 months later.
- A competition for audit managers closed in May 1997; the examinations were being marked in October 1998, 18 months later.

24.33 The Directorate could speed up the process by deciding, even before competitions are announced, on the selection strategy, process and techniques it will use. It could then develop position-specific selection tools such as interviews and written examinations. It could also screen and respond to applications as they come in, instead of waiting weeks. Skilled candidates for international tax positions at senior levels are rare, and are in demand in the private sector. Good candidates may lose interest if they have to wait long periods of time before being offered positions.

24.34 Statements of qualifications or selection profiles that provide a clearer indication of the experience, skills and traits sought in candidates could be developed to enable potential candidates to better assess their interest and their chances of success.

24.35 The Directorate is developing new job descriptions and classifying positions for some of the new staff it expects to hire over the next seven months. Job competency profiles will not be developed until after the planned 60 percent increase in current Directorate staff at headquarters has taken place.

24.36 We note that in a competition for senior auditor positions that closed in June 1998, the Department screened the applications and administered the written examinations that same month. The examinations were marked in July 1998; candidates were interviewed and the eligibility lists were completed in September 1998. This shows that it is possible to speed up the process.

Better Information Is Needed

24.37 Revenue Canada estimates that the average age of all the auditors in the Branch is 43.7 years. The Directorate will need to have a robust human resource strategy to ensure that as people at senior levels retire, their positions are filled with competent people. In addition, it will require a human resource information system to support its implementation of the strategy.

24.38 The Department has acknowledged that the need for reliable human resource information systems and data bases is a concern affecting all branches. It advised us that it has undertaken a major project to develop a new human resource information system to provide reliable information on key processes such as staffing, classification and performance reviews, as well as other employee information.

24.39 The Directorate will need to maintain information on the location, occupational group and level, and years of service of staff who leave or retire. It also needs to keep track of the numbers and levels of staff promoted to positions elsewhere in the Department.

24.40 The Directorate can use the information on staff losses to target retention strategies, recruitment activities, and classification and compensation structures. The monitoring of retention statistics is an essential component of human resource planning.

The Directorate Has Not Developed a Comprehensive Staffing Strategy

24.41 The Directorate has been aware since 1994 of its human resource problems. It has held a number of discussions and prepared and circulated papers that outlined various concerns. For example:

- In 1994, the Directorate recognized in its draft business plan that it would need a human resource plan to identify staffing needs and to recruit, select, train and manage qualified staff.
- A 1996 draft compliance and enforcement strategy for the Directorate indicated the need to address several human resource issues, including developing competency profiles, revising training programs, and developing new courses designed to fill gaps in knowledge and skills.
- In late 1996, the Branch started a project to determine the skills and competencies, career paths and training needs of staff to form an integrated approach to its human resource management.
- In July 1997, the Division Directors in the Directorate prepared a draft paper on staffing issues. It noted that although a large number of staff have applied for positions as managers and advisors, few had extensive experience in international tax. It also noted that TSO staff with experience in international tax generally did not apply for positions at headquarters. It further acknowledged that successful candidates for vacant positions might still require extensive training and development. The paper stated that because of requirements in domestic tax programs, combined with the fact that the Directorate often performs the role of “finishing school” for the best young talent in the Branch, many of the Directorate’s best employees were being promoted to positions elsewhere in the Department. It identified the need for technical expertise at headquarters and TSOs and it recommended the continued use of interim staffing measures including secondments, developmental assignments, acting appointments and temporary assignments.

24.42 We were advised that in April 1998, the Branch created a committee to define the “key principles and parameters” for a comprehensive human resource strategy. On 8 October 1998 we were advised that:

- most, but not all of the key parameters of the strategy had been defined. We asked to see them but, as of 11 October 1998, they had not been provided to us;
- in September 1998, a contract was issued to a professional firm to develop job competency profiles;
- the development of an employee skills inventory system had been put on hold;
- the results of a demographic study of the Branch’s work force would be ready in November 1998; and
- the Branch was developing four new audit training and development programs, which would be the “foundation” required to address recruitment issues and to proactively manage the longer-term human resource needs.

24.43 While these actions address some of the problems outlined in paragraph 24.41, we are concerned that they are only a piecemeal solution rather than part of a comprehensive human resource plan. This is particularly worrisome because the Directorate is planning to increase its staff at headquarters by 60 percent — from 80 people to 129 people — within the next seven months.

Conclusion and Recommendations

24.44 Our review of the International Tax Directorate's management of human resources identified problems that limit its ability to discharge its responsibilities and to manage the inherent risk to Canada's tax base caused by international transactions. Despite having recognized these problems for a number of years, the Directorate is still developing a comprehensive human resource plan and strategies linked to its business plan for the next few years.

24.45 During September and October 1998, the Directorate initiated a number of actions that it expects will address certain identified problems. However, this is only a piecemeal solution and it does not deal with the underlying problem.

24.46 In our view, failure to take urgent action on these matters will severely limit Revenue Canada's ability to manage the risks to Canada's tax base that international transactions represent.

24.47 If Parliament approves the establishment of the proposed new Canada Customs and Revenue Agency, the Department will become a separate employer and assume most of the responsibility for human resource management currently shared with central agencies. In the absence of a comprehensive human resource plan and strategies linked to the Directorate's business plan, the establishment of the new agency will not in itself resolve the problems outlined in this chapter. It is important that the analysis, planning and implementation of needed human resource initiatives be carried out as soon as possible to ensure that the Directorate can act appropriately to protect Canada's tax base.

24.48 **Revenue Canada should ensure that the International Tax Directorate:**

- **develops a comprehensive human resource management plan that is linked to its business plan;**
- **develops and implements a comprehensive staffing strategy to ensure that it has a full complement of staff with the continuity, qualifications, job performance and quality standards that are essential to carrying out its responsibilities; and**
- **has a human resource information system that provides reliable information on key processes such as staffing, classification and performance.**

Department's response:

1. *Development of a comprehensive human resource management plan, linked to its business plan.*

We concur with the importance of linking business planning with human resource planning. With the creation of the Canada Customs and Revenue Agency, the link between human resource plans and business plans will be strengthened and will be a more integral feature of the overall departmental planning process. Please refer to the Department's Action Plan, at the end of the chapter, for additional information.

2. *Development and implementation of a comprehensive staffing strategy to ensure a full staff complement with the necessary continuity, qualifications, job performance and quality standards.*

As noted by the Auditor General, the International Tax Directorate has recognized the need to address the particular human resource challenges that have emerged in the area of international tax and has acted to address a number of these challenges. Key activities to address these challenges are outlined in the Department's Action Plan at the end of the chapter.

In the longer term, as an Agency, the Department will have greater flexibility to tailor human resource strategies to specific business needs. The ability to develop new classification systems and remuneration rates, streamlined staffing processes and the ability to negotiate collective agreements based on the priorities and needs of the Agency and its unions will create an enhanced capacity to attract and retain key personnel.

3. *Development of a human resource information system to provide reliable information on key processes such as staffing, classification and performance.*

This important requirement will be addressed by the Corporate Administration System (CAS) project, currently under way in the Department. Please refer to the Department's Action Plan, at the end of the chapter, for additional information.

About the Audit

Objectives

The objective of the audit was to determine whether human resource management practices are sufficient to enable Revenue Canada's International Tax Directorate to manage the risks to Canada's tax base that are inherent in international transactions.

Scope

Our audit scope was restricted to the management of the Directorate's human resources. It was conducted at Revenue Canada headquarters and at various Tax Services Offices. We did not examine the International Tax Services Office.

Criteria

Revenue Canada's International Tax Directorate should have in place appropriate policies, systems, processes and practices to attract and retain sufficient people with the right skills and to provide an enabling environment for them to learn and work.

Approach

We interviewed officials in the Department and experts in the private sector, and reviewed appropriate documents, files and statistics.

Audit Team

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Revenue Canada provided the following action plan with its response to our recommendations (see paragraph 24.48).

THE DEPARTMENT'S ACTION PLAN

Revenue Canada has an International Tax Program that keeps abreast of change to remain effective and efficient. During the last few years, the International Tax Program has undergone significant restructuring and growth so that it can continue to address the many challenges involved in enhancing Canadian business competitiveness and protecting Canada's tax base.

The Auditor General has examined the human resource management of the International Tax Directorate and made a number of recommendations for addressing the issues he has raised in his report. The Department is taking, or plans to take, the following measures that will respond to the Auditor General's recommendations:

Development of a comprehensive human resource management plan that is linked to its business plan.

As part of its preparation for Agency status, the Department is moving toward an integrated planning process that will more closely link human resource and business planning. It is committed to having a business plan that incorporates a human resource plan. Branch business plans will be submitted in support of this process. The International Tax Directorate will form a component of the Verification, Enforcement and Compliance Research Branch business plan.

The Department will complete a Business Plan, including a Human Resource Management Plan, based on the new integrated departmental planning process by spring 1999.

Development and implementation of a comprehensive staffing strategy to ensure a full staff complement with the necessary continuity, qualifications, job performance and quality standards.

The Verification, Enforcement and Compliance Research Branch has undertaken a number of activities, outlined below, to further improve its capacity to attract and retain competent and professional staff, ensure that staff have the right skills and knowledge to meet future demands, and speed up the staffing process.

- A demographic study is under way.
- The development of competency profiles has begun.
- A Recruitment and Apprenticeship Program has been developed.
- An Accelerated Development Program for officers will be introduced in early fiscal year 1999-2000.
- An Assistant Director Verification and Enforcement and Assistant Director Investigations Trainee Program will be introduced in early fiscal year 1999-2000.
- A Self-directed Career Development Program will be introduced in 2000.
- Pre-qualified pools of candidates for forecast vacancies will be used to reduce the time required for staffing.

To address the significant growth in resources, actions have already been taken to staff vacant and newly created positions. The Directorate expects to complete staffing of these positions in 1999.

Implementation of a human resource information system that provides reliable information on key processes such as staffing, classification and performance.

The Corporate Administration System (CAS), a department-wide project dealing with financial and human resource information needs for Revenue Canada, is in progress. The human resources component will include enhanced human resource information and data bases on key human resource processes such as staffing, classification, performance reviews and employee information. Implementation will begin on 1 April 1999.

The training on the first phase of the corporate administrative systems will commence in February 1999.

Chapter 25

Transport Canada

Investments in Highways

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Transport Canada

Investments in Highways

Main Points

25.1 During the last 10 years, Transport Canada has spent about \$1.6 billion on provincial and territorial highways. At the time of our audit, it was involved in 24 multi-year cost-sharing agreements with provinces and territories under the Department's various highway investment programs. Over the last five years, annual total expenditures under these programs have averaged more than \$200 million.

25.2 Each agreement under the highway investment programs is administered by a committee of one federal and one provincial official. Transport Canada has provided little or no support to guide and facilitate the work of the four departmental employees who represent the federal interest on these committees.

25.3 Our analysis of Transport Canada's performance in managing and administering its highway investment programs revealed a number of significant weaknesses. The programs themselves have been managed and administered more like grant programs than the contribution programs they are (the latter require that funding be conditional on performance and on compliance with provisions of an applicable agreement). We noted the lack of a number of sound financial management practices. We also found deficiencies in the information supplied to decision makers in support of proposed new programs. In particular, information on the condition of roads was not properly disclosed; potential environmental impacts of proposed highway programs at the strategic decision-making level were not assessed, as is required; and alternative financing arrangements by provinces were not identified, nor were their implications for traditional cost-sharing arrangements evaluated.

25.4 Further, because its environmental screening and monitoring of projects lacked rigour and were poorly documented, we could not conclude whether Transport Canada had met its statutory environmental responsibilities when assessing (screening) individual projects. Moreover, we found a number of cases in which, contrary to statutory requirements, payments had been made before environmental screenings were completed.

25.5 Despite the hundreds of millions of dollars it has spent on highway investments over the past 10 years, Transport Canada has yet to conduct a program evaluation of its highway investment programs. Accountability reporting to Parliament needs to be strengthened.

25.6 Transport Canada is at a crossroads. There has been some pressure by the provinces for the federal government to renew or confirm its position on highway investments. The Minister of Transport has said that the existing national highway policy needs to be updated. Transport Canada needs to re-examine the National Highway Transportation Policy and make recommendations to the government as appropriate.

Introduction

Transport Canada has invested \$1.6 billion in provincial and territorial highways

25.7 Since the completion of the Trans–Canada Highway, Transport Canada has been the federal government’s key arm for investing in provincial and territorial highways. It has done so through a series of ad hoc programs. During the last 10 years alone, it has spent approximately \$1.6 billion on provincial and territorial highways (see Exhibit 25.1). At the time of our audit, Transport Canada was involved in 24 multi–year cost–sharing agreements with provinces and territories, largely under seven separate highway investment programs. Exhibit 25.2 provides information on the programs’ objectives. These investment programs are, in effect, contribution programs: federal funding is conditional on performance and on compliance with provisions of the applicable federal–provincial agreement. (The Appendix to this chapter elaborates on highway investment programs and on the distinction between grants and contributions.)

Exhibit 25.1 is not available, see the Report.

Exhibit 25.2

Federal–Provincial/Territorial Highway Investment Program Objectives

Strategic Transportation Improvement Program (STIP)	
Ontario	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance producer access to markets, improve level of service.
Northwest Territories	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance Territories producer access to markets, improve level of service.
Strategic Highway Improvement Program (SHIP)	
Yukon	Improve efficiency, improve level of service, support economic development (mining and tourism, in particular), promote safety.
British Columbia	Improve the economy, increase capacity, improve safety, rehabilitation.
Alberta	Increase level of service, reduce travel times, vehicle–operating cost savings, stimulation of the Western economy in areas of tourism, transportation of goods and services and development of natural resources, directly reduce the number of highway accidents and fatalities, reduce the cost of property damage, employment creation.
Saskatchewan	Enhance efficiency, promote safety, support industrial development, encourage tourism, enhance producer access to markets, improve level of service.
Manitoba	Relieve critical bottlenecks, improve safety, support industrial development, enhance producer access to markets, enhance efficiency, encourage tourism.
Quebec	Enhance efficiency and safety, improve competitiveness and economic development, employment creation.
New Brunswick	Increase level of service, reduce travel times, vehicle–operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, directly reduce the number of highway accidents and fatalities,

	reduce the cost of property damage, address current inadequacies of structural components of highway pavements and highway bridges and improved ride quality, employment creation.
Nova Scotia	Increase level of service, reduce travel times, vehicle–operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, reduce highway accidents and fatalities, reduce the cost of property damage, employment creation.
Newfoundland	Reduce travel times, vehicle–operating cost savings, stimulation of the Atlantic Canada economy in areas of tourism, transportation of goods and services and development of natural resources, employment creation, reduce the number of highway accidents and fatalities, reduce the cost of property damage, address current inadequacies of structural components of highway pavements and highway bridges and improve ride quality.
Highway Improvement Program (HIP)	
Nova Scotia	Improve efficiency, continued effort to build a high–standard, all–weather highway, provide connections to the major peripheral roads and serving smaller communities and resource areas.
New Brunswick	Improve traffic carrying capacity, highway safety, upgrading key regional highways, address urban congestion and truck routing, enhance tourism, improve movement of raw forest products, address structural components and pavement conditions, as well as ride quality, strength, traffic carrying capacity and highway safety.
Atlantic Freight Transition Program (AFTP)	
New Brunswick Nova Scotia Prince Edward Island Newfoundland	The objectives for all five of the provinces under AFTP are: enhance efficiency, improve access
Fixed Link Highway Improvement Program (FLNK)	
New Brunswick	Increase highway capacity, enhance highway safety.
Prince Edward Island	Increase highway capacity, enhance highway safety, relocation of facilities.
Canada-Newfoundland Regional Trunk Roads Agreement (RTR)	
Newfoundland	Develop a full and effective transportation system, contribute to the financing of the improvement of the Trans–Canada Highway in the Province of Newfoundland.
Canada-Newfoundland Trans–Canada Highway Agreement (TCH)	
Newfoundland	Develop a full and effective transportation system, contribute to the financing of the improvement of the Trans–Canada Highway in the Province of Newfoundland.
Construction of two Henri Bourassa Viaducts	
Montreal	To build viaduct “Albert Hudon” located between Albert Hudon and Pascal Gagnon and to build viaduct “Boulevard Marien” located near boulevard Marien.

Quebec (Outaouais) Road Agreement

Quebec

Transferring the Quebec (Outaouais) Road Agreement from the National Capital Commission to Transport Canada. To improve the highway system in the Outaouais.

Source: Federal-Provincial Agreements

25.8 Federal expenditures under Transport Canada's highway investment programs have averaged more than \$200 million annually over the last five years. Spending is expected to continue at an average of at least \$150 million a year until 2001, and at roughly \$60 million a year thereafter until 2003. It is noteworthy that in 1997-98 the Department's spending on highways represented a sizable portion — roughly 30 percent — of its annual net program and operating expenditures.

25.9 By March 1998, the Department had spent most of the more than \$1 billion of approved funding under programs in effect since the early 1990s. The government recently provided over \$150 million in additional funding under one program for two provinces, extending it for three more years; two other programs will be in effect until 2003.

25.10 Transport Canada and the federal government are at a crossroads. The provinces have been exerting pressure on the federal government to renew or confirm its position on financing provincial/territorial highway projects. Notwithstanding the recent extension of one program, the federal government's ultimate intent in this area remains unclear.

Focus of the audit

25.11 Overall, our objective for the audit was to determine how well Transport Canada has managed, administered and reported on its highway investment initiatives and programs during the last five years. We also assessed its performance in discharging its other responsibilities related to overall federal spending on highways.

25.12 Our audit concentrated on Transport Canada's highway investments, including a random sample of 96 projects approved from 1992-93 to 1997-98. The projects in our sample represented over 40 percent of the overall value of the projects funded in that period under the Department's highway programs that we reviewed.

25.13 Further details of the audit objectives, scope and criteria are presented at the end of the chapter, in the section entitled **About the Audit**.

Observations and Recommendations

25.14 We have organized our observations under the following three broad categories: establishing highway investment initiatives; managing programs and administering agreements; and reporting to Parliament. The first part of this section looks at federal policy in the area of highway investments and at the information supplied to decision makers by Transport Canada in support of such investments. The second reviews the role of the Department and its representatives in managing programs and administering agreements under them. The third part focusses on accountability reporting to Parliament.

Establishing Highway Investment Initiatives

National Highway Transportation Policy not amended in 25 years

25.15 The federal government has a national policy on highways that dates back to 1974. The policy provides guidance for the establishment and management of highway programs.

25.16 In a recent presentation to the Standing Committee on Transport and the Canadian Council for Public–Private Partnerships, the Minister of Transport acknowledged that a national policy on highways had existed in some form since 1919. However, he questioned the merits of the current ad hoc approach to the federal–provincial highway investments. He favoured a more integrated national highway policy, with clear expectations and objectives for both federal and provincial governments. The Minister also indicated that the provinces and territories had recently reiterated the need for a comprehensive policy on highways that would include a long–term federal commitment to funding.

25.17 Moreover, since 1974 there have been a number of substantive events in highway transportation that have had implications for decision making about federal highway investments.

25.18 The 1974 highway policy has never been amended to reflect the concept of a national highway system (Exhibit 25.3), defined in 1988 as part of a study. Thus, there is no clear policy on how the concept should guide the management of the Department’s highway investment programs. We noted that in some of the programs, projects have to be on the National Highway System to be funded. However, this was not a stipulation in all negotiated agreements we examined.

Exhibit 25.3 is not available, see the Report.

25.19 The highway policy also fails to reflect many other, more recent events in highway transportation, such as the devolution of federally owned highways to provinces and territories, Transport Canada’s objective to eliminate transportation subsidies (as stated in its 1996–97 Report on Plans and Priorities), and the emergence of alternative financing arrangements.

25.20 At the same time, the government has also created new highway investment programs for Transport Canada to administer, and has extended existing ones. In the absence of a clear policy, in our view all of these events, some with apparently conflicting objectives, increase the risk of fragmented, disconnected and inconsistent decision making by the Department. In fact, as we discuss later in the chapter, our observations on the way the Department has managed these programs and administered the agreements indicate a number of weaknesses. The absence of clear policy direction may be a contributing factor. Given the hundreds of millions of dollars spent by Transport Canada on highways over the past few years and its commitment to hundreds of millions more under programs that remain in effect until 2003, this is clearly a matter of concern from the standpoint of effective management of public resources. Without an up–to–date policy, in our view there is a lack of relevant, adequate guidance for establishing and managing Transport Canada’s highway investment programs.

25.21 In light of changing needs and recent developments, Transport Canada should re–examine the 1974 National Highway Transportation Policy and make recommendations to the government as appropriate.

Department’s response: The Department recognizes that any federal involvement in future highway programs needs to be pursued within the context of a more up–to–date and strategic transportation policy framework. Transport Canada is currently reviewing this framework. If and when new highway funding programs are deemed necessary by the government, the Department will seek to ensure that these are designed to reflect clear federal transportation

policy goals and program objectives. In the interim, action will be initiated to address many of the observations made in this chapter.

Transport Canada not fulfilling its lead role of co-ordination

25.22 In 1998, Transport Canada continues to be one of several federal entities that invest hundreds of millions of dollars in roads. Our analysis suggests that in the last 10 years, the total federal investment in roads and bridges in Canada has amounted to approximately \$3.5 billion. The federal departments with a significant role in managing, operating or subsidizing interprovincial, provincial and municipal roadways have included Public Works and Government Services Canada, Department of Canadian Heritage (Parks Canada), Agriculture and Agri-Food Canada and Indian and Northern Affairs Canada. The total federal investment in roads and bridges includes the Canada Infrastructure Works Program, which has provided subsidies through various implementing departments for a large number of provincial and municipal works, including roadways (see Exhibit 25.4).

Exhibit 25.4 is not available, see the Report.

25.23 Despite the number of players and the substantial amount of federal funds invested in highways, activities at the federal level are not co-ordinated in any systematic and formalized way. We note that the 1974 policy directed Transport Canada to play a lead role in co-ordinating information on highway investments at the federal level for the government's consideration, and to chair an interdepartmental committee to facilitate the process. The committee was required to prepare a comprehensive annual report on federal spending, as well as plans for potential future involvement in highway projects.

25.24 Although this direction has never been amended, the Department informed us that the committee remained active only until 1985, and that the comprehensive annual report was last published in 1990-91 due to a lack of resources. Given the sheer size of the federal highway investment, in our view the need for strategic co-ordination remains.

25.25 The government reinforced Transport Canada's lead role. In 1992 the government reiterated the need for integrated information on the condition of federal roads and the level of federal spending when it approved Transport Canada's \$500 million Strategic Capital Investment Initiative (SCII). The initiative provided funding for works on provincial highways as well as on federally owned infrastructure, such as highways in national parks. Transport Canada was directed to report to the Treasury Board Secretariat annually on the overall status of the initiative. Funds allocated under the SCII for works in national parks were exhausted by spring 1998, as were most of the funds for works on provincial highways. Although the initiative has been in place for five years, Transport Canada has never reported on its overall status and does not have plans to do so. By March 1999, all remaining agreements under the initiative will have expired.

25.26 Since 1993, the Transport Canada initiative has been Parks Canada's major source of funding for capital works on highways in national parks. Our review of the capital component of Parks Canada's business plan for 1996-97 to 2000-01 and our discussions with Parks officials indicate that in the course of its normal multi-year process of dealing with capital works, Parks Canada had made it known that more funding would be needed when SCII money ran out in order to upgrade roads to minimum national and/or provincial engineering standards.

25.27 This is the kind of information that Transport Canada could have been expected to provide in a report on the overall status of the initiative. In our view, the availability of co-ordinated information as envisaged in the 1974 policy would significantly enhance the government's ability to examine various options and to make timely decisions on highway investment, based on a full set of relevant facts.

25.28 We are concerned that the Department has not fulfilled its lead role of co-ordinating and reporting comprehensive information on federal involvement in highways.

25.29 Transport Canada should develop a strategy to enable it to fulfil its lead role, as directed by the government, of co-ordinating information on overall federal involvement in highways. It should also periodically review whether its responsibilities under this role reflect current circumstances, and make recommendations to the government as appropriate.

Department's response: Transport Canada will form and chair an interdepartmental highway committee to co-ordinate information on federal government highway expenditures.

Deficiencies in information supplied to decision makers on investment programs

25.30 We requested the information that Transport Canada had made available to the government for use in its decisions to fund new highway investment programs or to extend existing programs. We reviewed the available information that had been provided in support of the 1992 Strategic Capital Investment Initiative, the various extensions of the Highway Improvement Program from 1993 to 1998, and any other departmental investment program established during that period. For the most part, our review was limited to the Department's submission packages for the government's approval of new program funding.

25.31 During the course of our examination, we reviewed three cases in which we found that some of the information supplied to decision makers had been inaccurate. We also identified other weaknesses, as described in the following observations.

25.32 Information on condition of roads. We identified deficiencies in the information the Department had supplied for the government's use in deciding on the \$200 million in additional funding for the three most recent extensions of the Highway Improvement Program (in 1995, 1997 and 1998). In particular, we found that inaccuracies in the information on the condition of roads could leave the impression that the roads in question were well below minimum national standards, and that billions of dollars would be needed to bring them up to those standards. We note that the cost estimates supplied by the Department did not represent the cost of bringing the roads to minimum national standards but to proposed design and level-of-service features defined as part of a study on the National Highway System. The Department informed us that in the past, when seeking funding for the National Highway System, it had used the term "minimum national standards" whether it was referring to minimum national standards or to the proposed design and level-of-service features. We are concerned about this, as the cost of upgrading roads to a proposed design and level of service can be substantially and materially different from the cost of ensuring that existing roads meet minimum national standards.

25.33 Moreover, when Transport Canada requested the additional funding in 1997 and 1998, it had conducted a study on the ride quality of the roads on the National Highway System. Although that study had not estimated the cost of upgrading roads to minimum national standards, it had concluded that the pavement surfaces over which much of the traffic moved were acceptably smooth. We further note that according to the same study, the highways proposed for funding were well above the commonly accepted engineering threshold for acceptable surface roughness. Our review of the available documents leads us to conclude that none of this information was disclosed to decision makers when they were considering the two most recent extensions to the Highway Improvement Program.

25.34 We observed other cases in which the Department had supplied inaccurate information on the condition of our nation's highways. In its 1997 Annual Report to Parliament on the State of Transportation in Canada, the Department included the information noted above, with an updated estimated cost (\$17 billion) of upgrading the National Highway System to meet what it described in that report as "minimum national engineering standards". It also noted that the overall condition of the National Highway System had not improved in 10 years. As we have mentioned, the \$17 billion was actually the estimated cost of meeting a proposed design and service level. It did not represent the cost of upgrading the condition of existing roads to minimum national engineering standards.

25.35 Information on projects. The information provided to the government in 1995 in support of a proposed \$49 million extension of a highway improvement program indicated that the funding was being sought for additional projects. We found, to the contrary, that some of the funding was for stretches of road for which funds had previously been approved under the same program. We are concerned that without sufficient and relevant knowledge of a project's particulars and funding history, the government runs the risk of unknowingly approving project funds to meet cost overruns rather than specific program objectives.

Government directives not complied with

25.36 Environmental impacts not considered. Highway investments have implications for the environment: projects can contribute to noise, pollution and global warming, for example. Environmental impact assessments of policy and programs at the strategic decision-making level have been required by Cabinet directive since 1990. In reviewing Transport Canada's submissions for the funding of proposed programs, we found that it had not conducted any environmental impact assessments of the Strategic Capital Investment Initiative in 1992, or of any other programs since then, and had not indicated this to decision makers.

25.37 Exception noted in negotiated agreements. We also wanted to review Transport Canada's compliance with government directives on the parameters of the federal-provincial agreements under these programs — namely, program objectives, funding levels and cost-sharing ratios. Along with the Department's submissions, we reviewed the government's decisions on them and the agreements subsequently negotiated by Transport Canada with individual provinces or territories. We found in all the negotiated agreements that the program objectives, funding levels and cost-sharing ratios to be maintained throughout the life of the agreements reflected the government's directives.

25.38 In approving the most recent extension, however, the government added a requirement that all projects be subject to cost/benefit analysis. This requirement was not included in the agreement subsequently negotiated, and the Department did not inform decision makers of that fact. At the conclusion of our audit, none of the projects approved for funding under the latest extension program had been subjected to any cost/benefit analysis.

25.39 Transport Canada should ensure that any information on the condition of roads that it provides to decision makers in support of new program funding has been checked for accuracy and assessed for reasonableness. In the event that no such information is available, it should inform decision makers of that fact.

Department's response: Transport Canada will continue to provide decision makers with the most current and relevant information available on the condition of highways, as well as on the economic, social and environmental requirements for highway maintenance and upgrading. It will also include a statement about the completeness and quality of information, where applicable.

25.40 Transport Canada should comply with all government directives, including the requirement to conduct environmental impact assessments of proposed new programs as well as existing programs for which new funding is sought, and should inform decision makers if it is unable to do so.

Department's response: Transport Canada, in conjunction with the Canadian Environmental Assessment Agency, is currently updating its departmental procedures to ensure that Strategic Environmental Assessments (SEA) of departmental policies and programs are conducted. The Department has also committed, in its Sustainable Development Strategy, to fully implement the SEA process for any new program proposal involving direct budgetary transfers.

Poor handling of alternative financing arrangements

25.41 Traditionally, governments in Canada financed the construction and maintenance of highways entirely from tax revenues or the issuance of government bonds. Cost sharing of highway programs between the federal and provincial/territorial governments reflected that reality.

25.42 Since the governments paid all the costs, principles of cost sharing focussed on spending limits and the share of the costs that each was prepared to fund, often matched dollar for dollar. The highways would be freeways, and ownership would stay indefinitely with the provincial/territorial governments.

25.43 But given their budget constraints, since the early 1990s some provinces have been exploring and implementing alternative financing arrangements in an effort to undertake highway construction, improvement and maintenance more quickly and at a lower cost to taxpayers. These arrangements include a wide range of features. They often involve direct user fees or tolls, but could also entail the transfer of public assets to the private sector. During our audit, we reviewed the three cases that came to our attention in which Transport Canada had invested a total of \$76 million in provincial highways identified either previously or subsequently as subject to some concept of user pay, such as tolls.

25.44 Given the absence until 1998 of any government direction on alternative financing arrangements, we were interested in how Transport Canada had addressed the issue in general and, more specifically, in the three cases at hand. We found its performance lacking in several key respects.

25.45 Failure to analyze and obtain clarification from government. We requested the Department's analysis of the potential impact of alternative financing arrangements on the federal government's traditional position on highway investments. As a minimum, we would have expected timely analysis of their implications for such things as:

- eligibility of projects;
- the principles of traditional cost-sharing arrangements;
- expectations for a refund of federal investments;
- potential transfer of public infrastructure to the private sector; and
- applicability to the National Highway System, which encompasses key routes for interprovincial and international trade.

25.46 Transport Canada has informed us that it has not completed any overall analysis of the potential implications of alternative financing arrangements, even though it approved a project on a highway that as early as 1993 it had known would be tolled.

25.47 The Department did not seek clarification from the government on how to deal with alternative financing arrangements before entering into federal-provincial agreements under highway programs. The failure of the Department to respond to this emerging issue in a timely manner is particularly worrisome because the government has approved funding under several new highway investment programs since 1992, involving over a billion dollars in federal commitments. We note that none of the agreements predating 1998 addressed the issue of alternative financing arrangements, even in cases where the provision of additional funding had presented opportunities to amend these agreements.

25.48 Poor implementation of Minister's direction. Provinces have also expressed the need for clarification of the treatment of tolls under federal-provincial programs. In late 1994 and early 1995, two provinces requested that

the federal government clarify its position on its funding of toll highways in cost-sharing agreements under the Strategic Highway Improvement Program and the Strategic Transportation Improvement Program.

25.49 In both instances, the Minister of Transport responded that he was not opposed to tolls so long as the cost-sharing ratio in negotiated agreements was not modified as a result. Referring to the case under the Strategic Highway Improvement Program, the Minister added that any revenue from tolls would be considered funds from an additional source, to be dedicated to the particular project.

25.50 Also in that case, the Minister directed the departmental official on the management committee to review the alternative financing arrangement between the provincial government and a third party and ensure that it met federal terms and conditions. However, this was not done. The Department told us that the province had not made the agreement available for review by the departmental official before it was signed.

25.51 Although unable to implement the Minister's direction, the departmental representative did not so inform the Minister and signed the contract authorizations allowing the province to claim funding for project costs.

25.52 Consequently, the federal government may not have leverage to ensure that the province invests all proceeds from tolls into the project. We note that subsequent agreements signed by the Department also did not reflect the Minister's direction on the use of toll revenues from highways in which the federal government has an investment.

25.53 In the case of the Strategic Transportation Improvement Program, the province that in 1995 asked for clarification of the treatment of tolls opted not to introduce tolls on the highways in question.

25.54 **Change of status following funding.** In the third case we examined, we found that at the time the federal investment was approved, the provincial government had not announced specifically that it intended to toll those sections of highway. However, when the province decided to incorporate into a larger toll highway the sections of highway built with federal assistance, it became apparent that the current form of the agreements provided no legal leverage to the federal government over the treatment of its investment throughout the life of the highway.

25.55 Another province has recently announced that it intends to explore the possibility of transferring to the private sector a major toll highway that has received federal funding. It appears that nothing in the current agreements protects the public interest if assets are transferred to the private sector.

25.56 **Recent improvements.** In the two most recent funding extensions of the Highway Improvement Program, the federal government has precluded the imposition of tolls for 30 years unless it reaches an agreement with the provincial government on the treatment of the federal contribution. At the conclusion of our audit, one of the two federal-provincial agreements negotiated to cover these extensions reflected this prohibition. The other had not been finalized.

25.57 However, the Department has yet to clarify its position on the treatment of its investments under the Highway Improvement Program or to provide any related guidance to the federal officials on the management committees. While it is encouraging that some action has been taken on this matter, we are concerned that the one finalized agreement may not be workable as currently worded: it does not provide for monitoring over the 30-year prohibition period. Under the agreement, the management committee will continue to be in effect for only 18 months after the program ends. Furthermore, this agreement provides funding to projects previously funded under other agreements that do not contain such a prohibition. Which agreement takes precedence is something that needs clarification.

25.58 We do wish to acknowledge that in 1997, following a recommendation of the Standing Committee on Transport, the Department initiated a study by a federal-provincial/territorial working group on the applicability of

public–private partnerships in a Canadian context. Public–private partnerships are a form of alternative financing arrangement that generally involves some concept of user pay. Among other things, the working group has been tasked to gather information on experience worldwide with public–private partnerships. It is to develop a primer and analytic tools for reviewing whether and how public–private partnerships can be implemented in specific situations. At the conclusion of our audit, this study was still under way.

25.59 The government is on the threshold of deciding on new investments; Transport Canada needs to clarify the federal position on alternative financing arrangements. We are concerned that without proper clarification, it will be difficult for the federal officials on management committees to administer appropriately the projects under the various agreements. Moreover, whatever decision is made on the federal treatment of alternative financing arrangements, the Department needs to provide the necessary structures and procedures to enable a proper implementation of the federal position over the long term.

25.60 **Transport Canada should seek clarification of the federal position on the treatment of alternative financing arrangements for its highway investment programs and its application not only to tolls but to such arrangements in general. It should assess the need for entrenching that position in all new federal–provincial highway agreements, and take action as appropriate.**

Department's response: The Federal/Provincial/Territorial Working Group on Public–Private Partnerships, which is chaired by Transport Canada, is completing its final report, along with background studies. The report describes an approach to how federal contributions under cost–shared agreements could be considered in the case of highway projects involving toll revenues. The report also describes possible new instruments, other than cost–shared agreements, of federal–provincial/territorial co–operation in support of the National Highway System. While these approaches have been discussed within the Working Group, further discussion and negotiations with provinces and territories will be required before these can be reflected in future federal–provincial/territorial highway agreements.

25.61 **Transport Canada should provide departmental representatives with guidelines for managing projects under federal–provincial agreements that involve alternative financing arrangements. It should back those guidelines with appropriate monitoring practices to verify that they are being followed.**

Department's response: Agreements on future projects involving alternative financing arrangements will contain specific clauses addressing how federal expenditures are to be treated under alternative financing arrangements.

Managing Programs and Administering Agreements

25.62 In this section, we review the role of Transport Canada and that of its representatives who act on the federal government's behalf in managing programs and administering agreements. We discuss the accountability relationship between the two, as well as the financial management regime for the government contributions the Department administers in the form of highway investments.

Only a very few people manage and administer highway investment programs

25.63 Each of the 22 federal–provincial agreements we reviewed was administered by a management committee made up of one federal and one provincial official (see Exhibit 25.5). During the last five years, these committees have been required to approve, monitor and report on more than 600 infrastructure projects. The federal officials sitting on the committees were also responsible for approving several hundred construction contracts for the projects. There are four Transport Canada employees representing the federal interest on all 22 management committees. The responsibilities of the federal–provincial management committees are set out in each agreement and are essentially the same for both parties (see Exhibit 25.6).

Exhibit 25.5 is not available, see the Report.

Exhibit 25.6

Roles and Responsibilities of the Management Committee

The Management Committee is responsible as follows:

- The review and approval of all planning activities necessary for the implementation of the agreement.
- The review and approval of all projects necessary for the implementation of the agreement.
- The amendment, modification and substitution of projects from among those listed in Schedule B of the agreement.
- The submission of annual reports to the Ministers on the progress achieved under the agreement.
- Determining the extent to which a contract between the province and third parties may be varied without the approval of the Management Committee.
- Planning, evaluation and communication activities.
- Overview of the preparation and recording by the provinces of the official minutes for all management committee meetings and summaries of decisions. Also the approval and signature of the official minutes.
- Approval of projects to standards agreed to by the management committee (e.g. construction/maintenance and environmental standards).

Also for contract procedures the Management Committee is responsible as follows:

- The approval of contract awarding procedures (all programs).
- The review of tenders and award of contract to the most qualified and responsible tenderer submitting the lowest bid unless it is undesirable to do so (all programs except for Atlantic Freight Transition Program (AFTP)).
- The receipt of each advertisement for tender, together with notice of the time and place for tender opening and participate in the evaluation of tenders (Highway Improvement Program (HIP) and Trans-Canada Highway (TCH)/Regional Trunk Roads (RTR) programs only).

Source: Federal-Provincial Agreements

25.64 In addition to these four federal officials, only five other Transport Canada staff are directly involved in the day-to-day management of the Department's highway investment programs. Outside the function of the management committees, program delivery responsibilities include preparing submissions to the government for approval of new programs and extensions of existing ones; developing and designing federal-provincial agreements; instituting program financial controls; managing the divestitures of federal infrastructure; and reporting on the overall performance of the programs. The Surface Programs and Divestiture Branch is one of three lines of business in the Department that deal with highways, but the other two — Policy and Road Safety — have, at best, very limited involvement in the management of highway investment programs or the administration of the related agreements.

25.65 In view of the responsibilities assigned to Transport Canada and its representatives, the low level of resources the Department allocates to the delivery of highway investment programs is a matter of concern. In 1995, for example, it introduced the Atlantic Freight Transition Program; this added five new federal-provincial agreements for the Department to manage, including 300 new projects and many more contracts. Yet the level of resources allocated to the administration of highway investment programs remained at relatively the same level. We inquired about the impact of administering this transitional funding on Transport Canada's ability to deliver its various investment programs, but the Department was unable to provide any documentation.

25.66 Transport Canada should study its resource and financial management information requirements to support an effective management regime for its highway investments and institute measures as necessary to fill those requirements.

Department's response: Transport Canada will examine its resources and financial management information requirements and ensure that the appropriate measures are in place to meet its obligations.

25.67 We reviewed Transport Canada's performance in providing the necessary operational guidance and technical and administrative support for the management of the programs and for the federal representatives on the management committees. Specifically, we looked at how it selected and monitored projects under the various federal-provincial agreements and how it reported on their results. We selected a random sample of 96 projects, 86 of which were construction works.

25.68 As we indicate in the paragraphs that follow, although a number of financial management controls are embedded in the agreements to safeguard the Crown's interest, we found that the federal representatives on the management committees had not fulfilled their responsibilities to implement them properly. We also found weak performance by Transport Canada in its responsibility to institute the appropriate financial management regime for contribution programs, which highway investment programs represent. Exhibit 25.7 summarizes the major elements of an effective financial management regime.

Exhibit 25.7

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.

Source: Office of the Auditor General of Canada

Improvements needed in design of federal-provincial agreements

25.69 As already noted, one of Transport Canada's key responsibilities is the negotiation and design of federal-provincial agreements that provide a foundation to control the expenditures or funding approved under each program.

25.70 Most federal-provincial agreements on the funding of highway projects are similar in design. Each has three key sections, setting out the amount of money to be expended over a specified number of years and the program's control framework for such things as project and contract approvals, payment verification, project evaluations and reporting; the program's broad objectives (Exhibit 25.2) as approved by the government; and a list

of the projects to be completed under the agreement. The list specifies the locations of the projects, a general description of the work to be done, the estimated total costs and the planned expenditures for the current year.

25.71 A project is defined in the agreements as a set of undertakings, listed in Schedule B of the agreements. We expected to find clear, concise and complete descriptions of those undertakings. Instead, we found that many project descriptions were vague or incomplete. Where projects had received previous funding under different programs this was not indicated and, in one recent case, there was no description at all of the nature and extent of works to be funded.

25.72 We expected that Transport Canada would have done sufficient analysis to support the estimates of project expenditures presented to ministers for approval under the agreements. These expenditures represent the total amount eligible for cost sharing by the federal government and the province to complete a project. They range from a few million dollars to \$80 million for some projects — for example, to “twin” a highway section between two cities. The Department could not provide supporting documentation for the estimates.

25.73 There is thus a risk that additional funding will be needed to complete the projects or that the Department will not be able to fund its share of all the projects approved under the agreements. Further, despite the stipulation in some federal–provincial agreements that any excess project costs (cost overruns) over the total amount approved in an agreement were not to be funded, we found that in some cases the same stretch of highway had been funded sequentially under different programs. We note that the Department did not share this information with the government when seeking approval for the additional funding.

25.74 Because of the condition of departmental records, we could not estimate with any precision the total cost of these stretches of highway. However, millions of dollars were approved for those projects.

25.75 Funding the same projects under different programs is not a new phenomenon. Our review of departmental information found that this situation was known to Transport Canada as far back as 1987.

25.76 **Transport Canada should ensure that:**

- **adequate analysis of the project’s nature and estimated cost is completed prior to seeking approval for a project;**
- **federal–provincial agreements clearly describe the projects and reflect the true estimated costs of completion, thereby improving the Department’s ability to monitor these projects; and**
- **any project cost overruns are identified, monitored and reported appropriately to decision makers.**

Department’s response: Transport Canada will ensure that future agreements provide greater detail on the specifics of the projects covered under each agreement. More information will be provided on the cost of multi–year projects as well as the portions of the multi–year projects that are cost shared under the agreement.

Deficiencies in financial management information systems

25.77 Considering that so few people have been allocated to manage and administer such a large number of federal–provincial agreements, projects and contracts, we would expect to find a financial management information system that could compensate.

25.78 However, we found that Transport Canada’s financial management information system has many weaknesses. Not only is it not integrated, but we found that critical documents such as minutes of meetings, project

approval analyses, ministerial decisions, monitoring reports, payment decisions, and environmental screening results were dispersed in various places throughout the Department. In many cases, the documents could not be found. The Department's process to retrieve this information is labour-intensive.

25.79 Management trail is inadequate. As part of our review of the controls embedded in the agreements, we attempted to review the Department's promptness in making payments to the provinces. We were unable to complete our work because the Department could not trace payment approvals for a large number of projects in our sample. The Department's financial management information systems were unable to identify the dates when funding was approved and when payments were begun.

25.80 Moreover, basic information — such as the nature and scope of the project and the dates on which construction began and was completed — was not readily available and often was unavailable. In view of the hundreds of projects and contracts being funded, we believe that this type of information needs to be available to facilitate timely monitoring and reporting.

25.81 **Transport Canada should ensure that its financial management information systems provide an effective management trail to enable the Department to administer federal-provincial agreements adequately and to demonstrate sound management practices in the process.**

Department's response: Transport Canada will undertake measures to change its current information systems with a view to adequately administer federal-provincial agreements and to apply sound management practices in the process. This entails making file information more readily accessible through the subdividing of its Highway Agreement Central Records files, as well as amending its agreements and its computerized Financial Management System to ensure that provinces provide more detailed technical and financial information on the projects.

Transport Canada provides little or no guidance to federal officials on management committees

25.82 As we have noted, the objectives of federal-provincial highway investment programs are stated only in broad terms, like contributing to regional development, safety, efficiency, job creation, rehabilitation, tourism, resource development and so on. Further, federal-provincial agreements call for the Department to implement a number of controls set out in terms that are also broadly stated and not always self-explanatory. These controls include the approval of provincial bidding processes for individual project contracts under the agreements; the audit of claims and evaluation of projects; and the process for dealing with emerging issues.

25.83 Considering that Transport Canada has overall responsibility for highway investment programs, we asked it to provide us with any specific terms of reference to guide the work of its representatives who serve as the federal officials on the management committees. However, the Department has not developed any criteria to guide their work. Although Transport Canada issued a procedures manual in the late 1980s, it has become outdated and departmental officials no longer use it. Accordingly, decisions in all of these broad areas are left to the judgment of the individual federal official, presenting the risk that projects are not monitored as rigorously and consistently as the Department may believe and that decisions are made without due consideration to the Department's policies and the federal interest.

25.84 **Transport Canada should develop up-to-date guidance for the work of the federal officials on the management committees and help to ensure that the federal interest and the Department's policies are considered fully as the committees fulfil their responsibilities.**

Department's response: It is Transport Canada's view that existing agreements provide suitable guidance on the roles and responsibilities of the management committee representative. However, the Department is committed to provide greater clarity to the committee in future agreements.

Federal review supporting project approval lacks rigour

25.85 We discussed the basis on which federal officials approve individual project proposals. Our review of 96 projects approved by the management committees indicated that some fundamental management practices had not been followed. We found that most projects had been approved with little analysis by the federal official of the extent to which they would support program objectives. We saw no evidence that projects had been subjected to any prioritization based on analysis of needs, assessment of economic sustainability, environment, cost/benefit analysis, safety enhancements or any other criteria before they were approved. Further, in our review of federal files we found no evidence that federal officials had ever denied approval for a project.

25.86 As discussed in paragraph 25.38, the government recently directed Transport Canada to subject all projects under the Highway Improvement Program to cost/benefit analysis. We support this move; we believe that such analysis would be useful in prioritizing projects and maximizing value for scarce investment dollars. We asked the Department to provide us with the results of the cost/benefit analyses for any of the projects recently approved under the Highway Improvement Program. However, at the completion of our audit, no such analysis had been done.

25.87 Despite the hundreds of millions of dollars invested in highways, neither Transport Canada nor the federal officials on management committees gather any information on the economic sustainability of the investments. This information could provide, for example, some details on what it would cost to maintain and replace the completed infrastructure and on the capacity of regional economies to fund such costs in the future, as is required by federal–provincial agreements. This is information that could be used by the management committees to prioritize projects; it could also be submitted for the government’s consideration in decisions on funding.

25.88 **Transport Canada should ensure that the approval of projects follows a process of prioritization to identify the most cost–effective choices. The process of prioritizing proposed projects should take into account a number of relevant factors, including but not limited to cost/benefit analysis.**

Department’s response: Measures will be taken to ensure that management committee meetings reflect the details of the discussions that evolve around the project selection process.

Lack of information on safety when approving projects

25.89 We reviewed the extent to which Transport Canada has included safety considerations in its investment proposals and decisions. We also looked at the extent to which the federal officials on the management committees take safety into account in the approval and prioritization of projects.

25.90 We found that the Department often had no information on the expected safety impact of proposed projects at the time they were approved.

25.91 Although one objective of each cost–sharing agreement is to improve safety, at the federal level there is a serious lack of related information to guide the federal officials on the management committees.

25.92 We asked the Department and the federal official of each applicable management committee for a report on dangerous segments of federally funded highways. We were informed that this information was not available. We noted that under each of the federal–provincial agreements, there was money available for research to assist in the management of the program. To date, no safety research of national scope has been funded under these programs.

25.93 Currently, Transport Canada has no plan in place to gather information on numbers of accidents and fatalities by location, which would at least identify the most dangerous sections of Canada’s highways.

25.94 Transport Canada collects information from the provinces on road accidents and incidents, but generally uses it to compile statistics on vehicle safety and to summarize key statistics on incidents for its annual reporting. To date, the Department has made no attempt to compile information on “hot spots” or dangerous segments of highways. It believes that in its present form, the information that is available could not be used to identify dangerous stretches of road and it would not be cost-beneficial to do so. However, we have been informed that information on hot spots exists and is used by other levels of government and other federal departments to make road investment decisions.

25.95 We note that a 1993 Transport Canada study identified the need to improve data on the safety of the National Highway System; this would make better information available for decision making. To date, no safety data on the National Highway System have been collected by Transport Canada.

25.96 **Transport Canada should define its data reporting requirements for the collection of information on dangerous stretches of road and, where appropriate, use the collected information in its investment decisions, prioritization and approval of projects and assessments of program results. To the extent that it derives information from the provinces or other sources, the Department should clearly specify to those sources the parameters of its data requirements.**

Department’s response: Transport Canada will design data reporting requirements for collecting information on dangerous stretches of roads comprising the National Highway System. The Department will undertake a feasibility study to validate the data reporting requirements and to develop a costed action plan for data base development, data collection, storage and analysis.

Federal representatives on management committees do not ensure that projects meet any specified standards

25.97 Another key control included in each federal-provincial agreement is the requirement that the management committee agree on the standards to be followed in projects undertaken by the province. The committee is also required to determine the acceptable standard to which funded roads are to be maintained after the completion of projects. We expected that the management committees would agree on such standards and ensure that federal funds would be used to finance only projects that met them. We found, however, that the management committees had yet to agree on standards of construction and maintenance. Currently, neither Transport Canada nor the federal officials on the management committees have collected much evidence to indicate whether funded works have met any acceptable standard.

25.98 We do note, however, that the management committees have obtained some assurance by requiring provinces to submit affidavits by a professional engineer, certifying that the projects have met certain specified standards - usually those of the province. Despite this measure, though, we found that the federal officials on the management committees had not implemented this practice systematically. Affidavits had been received for only 31 of the 86 construction projects we reviewed. In many cases, the province had not provided the affidavit, or had been unable to because funding had run out before the completion of construction. As discussed in paragraph 25.73, these projects are often funded under different programs and agreements, making it difficult to implement this control.

25.99 In every case, the federal official on the management committee has yet to agree to the standard to which the province will maintain the federally funded segment of the highway.

25.100 **Transport Canada should ensure that the federal officials on the management committees implement all of the controls provided for in the federal-provincial agreements, and agree on minimum standards of construction and maintenance to be met in funded projects.**

Department’s response: Transport Canada will ensure that the obligations under each agreement are fully met and that identified ambiguous items are corrected.

Federal role in contract review and payment approval is largely passive

25.101 Each contract for each project under the many federal–provincial agreements is to be awarded only after the management committee has approved the competitive bidding process to be used by the province. We found in the projects we reviewed that the federal officials on the management committees had rarely been involved in approving that process.

25.102 In the late 1980s, the Department engaged engineers of the Department of Public Works to perform systematic reviews of the provinces' contracting procedures. This practice was later terminated, but the requirement to approve the competitive bidding process continues to be included in federal–provincial agreements.

25.103 The current process for approving contracts and contract amendments is largely limited to a financial exercise: the figures in Schedule B of the agreement are adjusted to reflect the amount of each contract and amendment, so that funding remains within the total amount approved for the agreement under the program. In our view, the Department's management and/or administration of contracts does not constitute an appropriate regime for controlling the programs and monitoring projects.

25.104 In addition to reviewing the approval of contract bidding procedures, we also reviewed the Department's process of assessing supporting documentation for provincial claims.

25.105 Federal review of support for provincial claims began only recently. The agreements are designed to allow the management committees to obtain independent assurance annually that the costs claimed by provinces are eligible for payment. Although most agreements stipulate that this work is to be conducted by an independent auditor, they do not define the nature and extent of the audit work.

25.106 We found that in all but two of our 96 sample items, the Department had received an audit opinion from provinces on the eligibility of costs. Each opinion is reviewed by Transport Canada's internal audit group to determine the extent to which it meets the intent of the agreement. In 1997, internal audit concluded that the audit opinions received from the provinces did not disclose the scope of the audit work, the definition of materiality used or the nature of the audit results, and that only a site review could attest to the adequacy of the audit. We were surprised to note that the federal representatives had not been involved in determining the nature and extent of the work to be carried out on their behalf by the provinces' auditors.

25.107 Late in 1996, Transport Canada's internal audit group undertook a review of highway investment programs. Generally, the review was to determine the extent of compliance with the financial requirements stipulated in the agreements and to verify that the claimed expenditures pertained to approved projects. The review was to cover the period from 1993, when most of the programs started, to 1998. The Department is currently in the reporting phase of its work; the internal audit group has presented a draft report to program management but the results had not been finalized at the end of our audit.

Management committees fail to meet requirement to report on projects

25.108 According to federal–provincial agreements, management committees are to prepare annual progress reports on projects for the Minister of Transport.

25.109 We found that these performance reports are not always prepared. Further, when the provinces prepare them, the federal officials on the management committees rarely approve them. One of the federal officials told us that this is because resources are insufficient to be able to corroborate the information in the reports prepared by provinces.

Environmental oversight needs to be strengthened

25.110 For any projects funded by the federal government, there is a legal requirement that an environmental assessment (screening or comprehensive study) be completed to determine whether a project is likely to cause significant adverse environmental effects. The funding department must ensure that the screening or comprehensive study is completed and that the report on it includes, among other things, a description of the project and its environment, a summary of potential environmental effects and their significance, comments from the public where appropriate, and a list and description of any mitigation measures needed to reduce significant adverse environmental impacts. We attempted to examine the means by which Transport Canada ensures that projects funded under highway investment programs meet those requirements and any other environmental requirements specified in the federal–provincial agreements. Our review was limited to 71 projects because the Department was not able to find screening reports on the other 15 construction projects in our sample.

25.111 While the environmental legislation dictates the factors that are to be considered in the environmental assessment of a project, the scope of the assessment is determined by the responsible authority. We expected the Department to have terms of reference for environmental scoping of highway projects, but we found that it did not. Moreover, the completed environmental assessment (screening) reports lacked documentation to demonstrate the nature and extent of consultation with external parties and the basis for Transport Canada’s assessment of potential environmental impacts. We are concerned that in the absence of standard terms of reference, adequate documentation and clear project descriptions, environmental assessments (screenings) could be inconsistent. Furthermore, it may not be possible to determine whether they have included all potentially significant environmental effects.

25.112 Transport Canada performs no systematic monitoring or follow–up to ensure that appropriate measures are taken to comply with legislative requirements. Furthermore, the limited monitoring conducted during project construction restricts Transport Canada’s ability to ensure that mitigation measures are being implemented. Moreover, without a systematic process of follow–up on environmental matters after construction, Transport Canada is unable to identify any unanticipated environmental damage and to collect the data it needs to ensure that future assessments keep pace with trends in this evolving area.

25.113 In several cases, we found that Transport Canada had not adhered to the requirement to complete environmental screenings before issuing any payments for individual projects. Of the 28 projects for which Transport Canada could locate both the environmental screening report and the first approved claim for payment, we found nine to which payments had been made before completion of the environmental screening.

25.114 Given the lack of proper documentation and reports on environmental screenings, we cannot conclude whether or to what extent Transport Canada has fulfilled its environmental screening responsibilities for the projects we reviewed.

25.115 Our observations on the issue of compliance with legislative requirements are consistent with those reported in Chapter 6 of the 1998 Report of the Commissioner of the Environment and Sustainable Development. That chapter focussed on the *Canadian Environmental Assessment Act*, the role of the Canadian Environmental Assessment Agency and the practices of federal organizations in conducting screenings under the law.

25.116 **Transport Canada should demonstrate due diligence in the management of environmental screenings of projects under highway investment programs, backed by an appropriate management information system that would facilitate compliance with environmental laws. Such a system should include a mechanism for monitoring unanticipated environmental effects in order to improve the screening process in future environmental assessments.**

Department's response: It is Transport Canada's view that the Department has fully complied with the Canadian Environmental Assessment Act (CEAA) for all projects undertaken in its highway agreements. The Department is committed to developing a centrally located management system that fully documents its compliance with the CEAA.

Reporting to Parliament

25.117 We looked at the extent to which Transport Canada provides Parliament with appropriate accountability information on outputs and outcomes of spending and on departmental performance in administering highway investments.

Program evaluations have yet to be conducted

25.118 Under the federal–provincial agreements, Transport Canada is entitled to conduct evaluations of programs and projects. However, we found that only 6 of the 96 projects we reviewed had been subjected to any form of evaluation. At the program level, the Department informs us that it has yet to conduct any formal evaluation of its highway investment programs.

25.119 Failure to conduct timely evaluations contributes to the lack of information on outcomes achieved with the hundreds of millions of dollars spent each year under highway programs. It also means that the Department has missed opportunities to learn from experience and, where applicable, to use information on results to improve the design of existing highway investment programs or new programs.

25.120 The importance of program evaluation was emphasized in 1994 by the Deputy Minister at the time, who strongly suggested the need to perform such evaluations before committing to further federal investment in highways.

25.121 Further, we were informed that the more recent programs funded through the Strategic Capital Investment Initiative will not be evaluated until two to three years after they end. The Department has yet to develop a framework for evaluation. This means there is a risk that it may lack the data it will need to carry out the evaluation.

25.122 **Transport Canada should define the parameters for evaluating the most recent highway investment initiatives, and establish procedures to ensure that it has the information it will need when it decides to conduct a formal evaluation. It should conduct evaluations on a timely basis, to serve as input into the decision–making process when new investment initiatives are proposed.**

Department's response: Transport Canada will prepare an evaluation framework for any new highway program so that its performance can be monitored and data will be available for a future policy evaluation.

Annual report on the state of transportation enhances accountability information to Parliament

25.123 Transport Canada has broadened the information it provides to Parliament on the state of transportation in Canada, in compliance with the reporting requirements of the *Canada Transportation Act*. The report has provided a vehicle for aggregate information on road spending, both capital and operating, by all levels of government, together with some information on the National Highway System, among other things. In the past, the information provided to Parliament on federal spending was limited to that published in the Public Accounts of Canada under each federal department involved in highways. The information was fragmented and not timely. Information available in other public documents through the Main Estimates process was inconsistent, fragmented and often incomplete. To date, two annual reports have been released under the requirement of the *Canada Transportation Act*.

25.124 We are encouraged by the Department's effort to provide aggregate spending information on the state of transportation. With respect to road surface transportation, however, we found that the quality and reliability of the information could vary significantly depending on its source. In some instances, we found information to be incorrect and incomplete and, in one case, the conclusion to be unsubstantiated (see paragraph 25.34). During our audit we asked the Department for any terms of reference or guidelines that it had in place to ensure that information gathered from various sources, analysis of that information and the resulting observations in the annual report would meet a minimum standard of quality. We found that the Department had no such guidelines. Nor has it attempted to obtain assurance about the reliability of the information it gathers. The annual report does not make this limitation known to the reader.

25.125 We also noted, in the first two annual reports, differences in the kind of information the Department provides on the state of road surface transportation. We observed that the Department has not established a framework for annually reporting the information required under the Act, to permit at least a year-over-year assessment of the state of this mode of transportation. Nor has it defined what other information it still needs to gather to meet all of the Act's reporting requirements. Still, given that the Act is relatively recent, we think the Department has taken some first good steps to tackle these new reporting requirements.

25.126 We also reviewed Transport Canada's 1997 Performance Report for specific information on its performance in administering highway investment programs. However, we found that the information presented was limited to statistics on spending under the programs.

25.127 **Transport Canada should establish terms of reference for ensuring that information it incorporates in the Annual Report on the State of Transportation in Canada meets a minimum standard of quality. It should identify the specific year-over-year information required to permit a proper assessment of the state of transportation. Further, the Department should ensure that it provides Parliament with information on its administrative performance in managing highway investment programs.**

Department's response: Transport Canada is continually improving the quality of the Annual Report and an evaluation, which is currently under way, includes a survey of the report's clients. Results will be used to improve the report's usefulness. (Where applicable, the report will clarify that the information being provided is "preliminary" or "estimated".)

Conclusion

25.128 During the last five years alone, Transport Canada has spent over \$1 billion on provincial/territorial highways through a series of ad hoc highway investment programs. At the conclusion of our audit, most of the funding approved under the programs had already been spent. There has been considerable pressure by the provinces for the federal government to renew or confirm its involvement in highway investments. To the extent that Transport Canada provides information in support of such decision making, it needs to ensure that the information is accurate, considers the potential environmental impacts and also considers the potential implications of alternative financing arrangements for future federal involvement in highways.

25.129 Our audit of the Department's management and administration of programs revealed many weaknesses that, in our view, need attention to ensure that the interests of the public are protected if existing programs continue, and in the event that new programs are established.

25.130 Overall, we found that Transport Canada has managed and administered its highway investment programs more as grant programs than the contribution programs they are. That is, among other things, it has failed to exercise the controls entrenched in the agreements under which these investments were made. We also found that the

Department has provided very few resources to manage and administer the programs, and little or no support to guide and facilitate the work.

25.131 Although the Department has improved its accountability reporting on the level of highway spending, we found it has failed to discharge its leadership responsibility to co-ordinate information for the government on federal highway spending overall.

About the Audit

Objectives

Our overall objective was to examine Transport Canada's performance in managing, administering and reporting on its highway investment programs and initiatives during the last five years. We also assessed its performance in discharging its other responsibilities in relation to the federal government's overall spending on highways.

Scope

We focused on the quality of the information made available by Transport Canada for decision making; its overall management regime for highway investments; the administrative responsibilities of the federal representatives on management committees, including the approval and monitoring of projects under federal-provincial/territorial agreements; the adequacy of environmental screenings; the quality of accountability reporting; and the Department's responsiveness in handling emerging issues — in particular, alternative financing arrangements.

We did not audit the role of the provincial representatives on the federal-provincial management committees; nor did we assess the work of other federal and provincial entities that might be involved in environmental assessments and screening of highway projects. Further, considering that funding and cost-sharing proportions are directed by the government, we excluded those areas from our audit.

Criteria

We expected that:

- government investment decisions on highways would be guided by a clear policy and strategy and that the information presented to decision makers would be accurate, relevant, timely and complete, and would consider environmental implications as and when required;
- agreements entered into with provinces would support an effective and efficient contribution regime, mitigate risks to the Crown, and comply with government directives;
- sound management practices would be followed in the management and administration of federal-provincial/territorial agreements;
- projects would be approved only when they complied with program and departmental objectives and when they followed a process of prioritization to ensure the most cost-effective choices;
- investment programs would be appropriately monitored and evaluated for effectiveness, and the results reported to decision makers;
- government would be kept abreast of new developments and trends in highway financing to ensure that risk management practices for its investments continued to be appropriate and relevant and taxpayers' interests appropriately safeguarded; and
- Parliament would be provided with appropriate accountability information in the form of spending outputs and outcomes and on departmental performance in administering investments in roads.

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Appendix

Federal Highway Investment Programs

Highways are by far the busiest transportation system in Canada

Transport Canada reports that the majority of Canadians use highways to travel between cities. Similarly, most freight travels by road, with truck transport accounting for 72 percent of freight revenue. The vast majority of roads in Canada are owned and maintained by provincial or local governments. Roads under federal jurisdiction represent only a small proportion of the Canadian road network. Nevertheless, since 1919 the federal government has been providing financial contributions to provinces, territories and municipalities to help them in developing their road networks. For example, it contributed hundreds of millions of dollars in the 1950s and 60s to help build the Trans-Canada Highway. Since then, the federal government has contributed hundreds of millions more to help fund provincial and territorial highway construction, largely through bilateral cost-sharing agreements with individual provinces and territories (see Exhibit A.1). Transport Canada has been the key federal department in administering such federal-provincial/territorial agreements. It is one of five federal entities investing in road infrastructure; however, it is the only one involved in bilateral highway investment programs.

Exhibit A.1 is not available, see the Report.

Government establishes parameters for highway investment programs

The federal government establishes the broad parameters for highway investment programs, which includes setting funding levels by program and by province or territory. It also specifies program objectives and cost-sharing arrangements, which can vary significantly from program to program. For example, some provinces may share costs equally with the federal government. Others may contribute 30 or 50 percent, or the federal government may provide 100 percent of the funding for a particular program.

As the federal government then directs, Transport Canada is responsible for setting up the highway investment programs and ensuring that negotiated federal-provincial/territorial agreements reflect both the direction and the fundamental principles that the government has approved under each program. Once negotiated, each agreement is administered by a federal-provincial management committee of two: one federal official and one provincial official. Nevertheless, Transport Canada still has overall responsibility for the programs under which these agreements exist.

Generally, these investment programs apply to one or more provinces and territories, and help fund various types of highway construction projects such as paving, resurfacing, adding additional lanes to existing highways and constructing new highways.

The objectives of all the programs are stated in similar broad terms — to support regional economic development, to improve highway safety and efficiency and, in a few cases, to create jobs. However, the federal government's reasons for creating each of the programs have varied considerably. They range from fulfilling constitutional obligations to eliminating ferry and transportation subsidies and other statutory programs, to stimulating Canada's economy by improving provincial and territorial highways. In the 1990s these programs involved extensions of the New Brunswick and Nova Scotia Highway Improvement Programs, first established in the 1980s; the 1990

Newfoundland Transportation Initiatives, earmarked for capital works projects on the province's Regional Trunk Roads and the Trans-Canada Highway; the Strategic Highway Improvement Program and the Strategic Transportation Improvement Program under the 1992 Strategic Capital Investment Initiative, which provided all provinces and territories with funding; the 1995 Atlantic Freight Transition Program, extending to the Maritime provinces as well as the province of Quebec; and the 1996 Fixed Link Highway Improvement Agreements with Prince Edward Island and New Brunswick (see Exhibit A.2).

Exhibit A.2 is not available, see the Report.

Although Transport Canada's investments have gone principally to help fund provincial and territorial highways, under one of the investment initiatives the government has provided some funding for works to be undertaken on federally owned infrastructure, such as highways in national parks.

Transport Canada investments do not give the federal government a proprietary interest in the infrastructure or segments of highways funded under any of the programs. Rather, the term "investment" is meant to reflect the broad benefits and savings to Canada flowing from the objectives the programs are intended to achieve. The investment programs are, in effect, contribution programs: federal funding is conditional on performance and on compliance with provisions of the applicable federal-provincial agreement (see Exhibit A.3).

Exhibit A.3

Grants and Contributions: A Comparison

Grants and contributions are part of the category of expenditures known as transfer payments. Transfer payments are transfers of money from the federal government to individuals and to organizations of various types, including businesses or other governments.

Grants

Grants are unconditional transfer payments for which eligibility and entitlement may be verified. This means that if an individual or organization is eligible for a grant, the appropriate payment can be made without the recipient having to meet any future conditions. There is generally less accountability for grants.

Contributions

In contrast, the payment of a contribution is subject to performance conditions that are specified in a contribution agreement. The recipient must continue to show that these conditions are being met in order to be reimbursed for specific costs over the life of the agreement. The government can also audit the use of contributions, whereas this is usually not a requirement for a grant.

Source: Office of the Auditor General

Chapter 26

Contracting for Professional Services

Selected Sole–Source Contracts

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Contracting for Professional Services

Selected Sole–Source Contracts

Main Points

26.1 To ensure that the principles of best value and open access are followed in contracting for goods and services, the government’s contracting regulations require that contracts valued at more than \$25,000 be let, except in very limited circumstances, through a competitive, open tendering process. Recent work by our Office as well as a report by the Standing Committee on Government Operations show that departments use sole–source contracts extensively. This is a matter of considerable concern because sole–sourcing works against the principle of open access and puts the achievement of best value at risk. The total value of sole–source service contracts awarded in 1995 was about \$1.4 billion.

26.2 We audited a sample from five departments of 26 sole–source contracts for professional services. We selected this type of contract because previous work had led us to believe that it was a high–risk area. Most of the contracts in our sample would not, in our view, stand the test of public scrutiny. Nor do they reflect open access to contracting opportunities with the federal government. The total initial value of these contracts was \$16 million.

26.3 In our sample of contracts we found many instances in which needs analyses, definition of requirements and procurement planning had been inadequate. Departments often underestimate the nature and scope of the work required, and do not always clearly specify what contractors are to deliver. We could find little evidence of contract management: it often appears that the contractors determine what is required, how much effort it will take and at what point the job will be considered completed.

26.4 The justifications for over two thirds of the sole–source contracts we audited did not conform to the exceptions allowed by the Government Contracts Regulations and as defined in the Treasury Board Secretariat’s Contracting Policy. This practice results in too many “one–horse races”.

26.5 Departments issue many oral contracts that remain unsigned for long periods of time. Treasury Board states that the terms and conditions of any contract issued should be in writing and should be signed as soon as possible after the contract is awarded.

26.6 In several cases departments were not able to demonstrate that their managers had, as required by the Treasury Board Secretariat’s Contracting Policy, documented and assessed the extent to which contractors had fulfilled the contract terms. In the absence of appropriate certification and documentation of what the contractors delivered, neither we nor management can be assured that due regard to economy was shown in the letting of those contracts.

26.7 In most of the contracts we examined, government regulations were not followed. Clearly, we are concerned about this. In 1997, we examined the contracting process and concluded that the current regime that governs contracting was itself sound. Similarly, the Standing Committee on Government Operations examined the contracting process and concluded that the rules were sound. The problem we found is that departments disregard the rules that apply to sole–sourcing. Moreover, disregarding them appears to involve no significant consequences

for either the managers responsible or their departments. (This was the first in a series of contracting compliance audits planned by the Office.)

Introduction

26.8 Two complementary principles are central to government contracting: best value and open access to contracting opportunities. The principle of best value is to ensure that in acquiring goods or services for the Crown, the government receives the best combination of value and price. The principle of open access gives all qualified vendors a fair chance to do business with the Crown without political or bureaucratic favour. An open, competitive bidding process provides the best guarantee that both of these principles will be respected.

26.9 In certain limited circumstances, however, it may be impractical or undesirable to hold an open competition and a directed or sole-source contract must be let. The Government Contracts Regulations recognize and provide for this when the value of the contract is relatively small, there is an urgent need for the good or service, it is not in the national interest to have an open competition, or the good or service is unique and can be obtained from only one source.

26.10 In 1994 the House of Commons Standing Committee on Government Operations, concerned about the level of non-competitive or sole-source contracting, began an investigation that was to last for more than two years. During its hearings, the Committee heard extensive testimony on contracting with the government — and on the rules that governed the process — from the private sector, operating departments, Public Works and Government Services Canada (PWGSC) and Treasury Board Secretariat. In its report issued in April 1997, the Committee concluded that while there had been some improvement in government contracting, much remained to be done. (See Appendix A for the Committee's Report.)

26.11 The Committee also reaffirmed that the principles of best value and open access were central to the government contracting process. Its recommendations were focussed on ensuring that greater respect would be paid to these principles in the future.

26.12 Normally, the government responds formally to reports of standing committees within a specified period of time. However, we were informed that in this case the government will not be responding to this Committee's report because the dissolution of Parliament for the 1997 election meant that the report died on the order paper. The government has stated that the recommendations of the Committee were reviewed internally and influenced later policy revisions.

Extent of the government's contracting for services is significant

26.13 One of the concerns of the Government Operations Committee was the need for current and credible information on government contracting activity. We found that the most recent information available at the time of our audit was the Treasury Board Secretariat's Annual Contracting Activity Report for the calendar year 1995. Although this information is dated, it does offer a general sense of the extent to which the government contracts for services.

26.14 In 1995 the government's total spending on service contracts amounted to about \$4.4 billion. Of this amount, \$649 million (or about 15 percent) represented contracts for less than \$25,000. As of October 1996, the regulations permit contracts for \$25,000 or less to be let without competition (previously the limit was \$30,000). This recognizes the fact that although competition for small contracts is encouraged, it is not always cost-effective for the government or industry. The rest of the service contracts — amounting to some \$3.7 billion — were for initial amounts greater than \$25,000 and hence, except for those that met the criteria for exemption, would have been expected to be let on a competitive basis. However, the data show that competitive bids were sought for only 51 percent of those contracts.

26.15 In the last few years there have been significant developments that have affected contracting activity. These include:

- increased delegation of authority to individual departments for contracting of services;
- the option to use service providers other than PWGSC (the government's common service provider);
- higher dollar levels delegated to departments for use of MERX, the current electronic bidding system that is replacing the older Open Bidding Service;
- increased use of the MERX/Open Bidding Service, including Advance Contract Award Notices; and
- increasing numbers of contracts for services and at higher dollar values.

26.16 As a result of these developments, departments can be expected to engage more often in direct contracting for services without the assistance of PWGSC in its role as the independent common service provider. Because service contracts are generally let directly by departments, we did not include PWGSC in the scope of this audit.

Focus of the audit

26.17 Chapter 6 of our 1997 Report presented the results of our audit of contracting performance. The chapter set out the general roles, responsibilities and expectations in the government's use of contracting for goods and services. A major contribution of the audit was the development of performance criteria and indicators for contracting, as well as a broad framework for conducting future audits of contracting. (See **About the Audit** at the end of this chapter and Appendix B for a discussion of the audit criteria, which we also used in the present audit.) In addition, in our 1997 Report Chapter 19 on the commercialization of the air navigation system we raised concerns about the handling of some specific contracts.

26.18 In light of our earlier findings and the Government Operations Committee's report recommendation that we audit sole-source contracts, we decided to begin a series of audits of contracting that would focus on testing specific transactions for compliance both with the criteria we had established and with government policy and regulations. This audit was the first in that series. A review of a variety of sources indicated that sole-source contracts for professional services represented a particularly high risk and, accordingly, they became the focus of this audit.

26.19 We examined a sample of 26 sole-source contracts in five departments to determine, among other things, whether in letting these contracts the government had adhered to the governing principles and regulations.

26.20 We had hoped to be able to take a statistical sample of sole-source contracts for professional services. However, we found that the nature of the information maintained in central agencies and most departments made this impractical. We decided to select about five contracts let in 1996 from each of five major departments — Correctional Service Canada, Fisheries and Oceans, Health Canada, National Defence, and Transport Canada. Because ours was a selected sample, the results cannot be generalized statistically to the broader population of similar contracts. However, the cases were not chosen in any targeted or biased way that would have led to the sample being unrepresentative of the practices used in sole-sourcing contracts of the type we audited. A discussion of some of the cases is presented on pages 26-10 to 26-12.

26.21 We focussed only on the actions of government officials as they entered into and administered these contracts. We did not audit the contractors, and we make no comment on their actions.

Observations

26.22 The results of our audit of the contracts in our sample are summarized against our criteria in exhibits throughout this section. The exhibits indicate the number of contracts in the sample that either met or failed to meet the particular criterion. Our audit results are presented by stage of the contracting process. First we look at contract screening, the stage that involves deciding whether and for what to contract. Next we look at the decision to use a sole source and the justification for that decision. Then we look at the process that management used in its discussions with contractors to provide price and value protection for the Crown. Next, we look at the controls exercised upon receipt of the deliverables under the contract and controls over the payment process to ensure that work was done according to the contract and that full value was received before the contractor was paid. Finally, we look at contracts that were amended and assess the controls on the use of amendments.

Weaknesses in Documentation and Monitoring

No file contained all of the required documentation

26.23 The Treasury Board Secretariat's Contracting Policy states:

...contract files should be established which will provide a complete audit trail containing details on matters such as options, decisions, approvals, amendments, if any, etc., and identifying the officials or authorities who made them. This is extremely important for answering questions and evaluating results.

26.24 We expected, when we began the audit, that most of the documentation we would need for our audit work would be readily available in the contract files. However, we did not find any files that in our view met all of the Treasury Board Secretariat's requirements. Further, in many instances, departments were unable to provide even key documentation and, because of staff turnover, the people who might have explained the gaps were no longer available. Accordingly, a "not met" indication in the exhibit tables means that either the file was complete but the quality of the documentation was below standard, or the file was incomplete and the department was unable to supply the missing documentation. In either instance, a "not met" indicates that we, as Parliament's auditors, are unable to provide assurance that managers have shown due regard to economy and respected the principles of open access and best value.

Monitoring of compliance with contracting policies is poor

26.25 The section on monitoring in the Treasury Board Secretariat's Contracting Policy discusses the reporting mechanisms and performance indicators that are used for contracting:

Two mechanisms will be used: departmental audits and an annual report on contracting. Departments will be evaluated on their compliance with contracting policies and the level of competitive contracting. All departments and agencies awarding contracts and/or amendments, are required to submit an annual report to the Treasury Board Secretariat on all contracting activities....The Treasury Board Secretariat also conducts periodic reviews of contracts for the services of individuals, including those for less than \$5,000.

26.26 We found, however, that actual practice is very different. The five departments we looked at have done some internal audit work on contracting practices, but generally not at a significant level. Further, as we have noted, the most recent government-wide report on contracting activity was for 1995. We asked the Treasury Board Secretariat for its own assessments of departmental compliance, and particularly its reviews of contracts for the services of individuals. We were informed that no such assessments and reviews exist.

Correctional Service Canada

Unjustified sole sourcing based on a presumption of uniqueness

In this case, Correctional Service Canada justified a sole-source contract based on its presumption that the selected contractor was the only one capable of satisfactorily delivering the service.

The Service wished to adopt a new information technology system for linking its various computers. To do this the Service decided to award a contract for \$200,000 to a contractor. The justification was that since the contractor owned the software to be used, it was best placed to provide the lowest-risk transition for the Service. However, we note that management took no steps to test this presumption.

No bids or expressions of interest were requested from other potential suppliers. An Advance Contract Award Notice was posted. However, in the absence of sufficient detail about the work to be done, other potential vendors would have been unable to determine whether or not they would be interested in bidding.

Given the nature of the services being offered and the wide experience with the software in the industry, it is reasonable to expect that had bids been solicited, other suppliers would have come forward. The Service could then have selected the supplier that represented best value. It could have included in its selection criteria one that looked at how well the bidders had identified and mitigated the project's risks.

Creation of a sole source

In this case, Correctional Service Canada improperly created a situation in which sole sourcing was thought to be necessary. Necessary steps to ensure best value were not taken.

The Service required a contractor to install voice interception equipment. The right to do so is closely controlled, and the contractor would have to be licensed by the Solicitor General of Canada to do the work. The Service sought out the potential contractor and supported the contractor's application for the required licence (renewable annually), which was then issued by the Solicitor General. Then, as only that contractor had the required licence, it was the only company able to do the work and a sole-source contract was awarded on that basis.

During the last five years, the contractor has received a number of sole-source contracts for this type of work. Future contracts are likely, given that the Service plans to install more modern surveillance equipment in many of its facilities over the next few years. The contracts for future work are estimated by the Service to have a value of up to \$600,000.

We have a number of concerns about this arrangement. First, the Service did not proceed in the prescribed order. It should initially have solicited bids from potential suppliers and included in the qualifications the requirement that the selected supplier meet the conditions established by the Solicitor General for receiving the necessary licence. Second, the practice of repeatedly contracting with the same firm is contrary to the intent of government contracting policy. Third, we found no evidence of price support — that the fees the government paid were “market rate”. Finally, the “sole-source” justification failed to acknowledge that someone else had done the installation work before the company was formed, and that eventually the client might have to find a replacement if and when the contractor stopped operating.

Fisheries and Oceans

Excessive amendments

This case illustrates the problems that can arise when entering into a contract without a clear understanding of the scope of the work to be done and the amount of work required to do it. The Department arbitrarily estimated that a contract to provide financial analysis services would not exceed \$25,000 and, on that basis, let it without requesting bids. Ultimately, however, the contract was amended to an amount 12 times the original amount.

The Department asked a contractor to carry out a financial review of internal costs. The Department estimated that the task would take approximately three months. The firm chosen to do the review had extensive relevant experience in work done for other federal and provincial government departments.

Departmental officials told us that they did not have any in-house expertise to determine whether \$25,000 would be adequate to carry

out the work as proposed. They did not seek advice on the scope of the proposed work or ascertain whether other firms would be prepared to submit bids. The Treasury Board Secretariat's Contracting Policy states that where the estimated expenditure does not exceed \$25,000, departments may set aside the competitive process. However, contracting authorities are expected to call for bids whenever it is cost-effective to do so. In circumstances where management is uncertain as to the level of effort needed to carry out the task, seeking bids based on a well defined statement of work would help to ensure that the Department knew the approximate cost of the work before entering into the contract.

After work began, it became apparent that more time would be needed to complete the project. Accordingly, the terms of the original contract were amended to extend the time to approximately 12 months and increase the value to \$300,000.

Health Canada

Use of prior experience to justify sole-sourcing

In this case, prior experience with related work was used as the justification for sole-sourcing.

In April 1996, Health Canada identified a need for a contractor to carry out work on an information technology project. It decided to use a contractor who had been doing work for the Department since 1995 and who was available for further work. It was decided that because the time frame was short and the contractor was already familiar with the project, the contract, initially for \$50,000, would be sole-sourced. No Advance Contract Award Notice was posted. The contract was later amended to \$90,125 and the delivery date was extended by three months. Subsequently the amendment was cancelled and a number of small sole-source contracts, related to the project and using the same contractor, were let.

This justification does not meet the standard required by Section 6(d) of the Government Contracts Regulations, which requires that the supplier be proved unique before this exemption is invoked. Management took no steps to ensure that no others could have done the work in accordance with its needs. Indeed, nothing on the contract file suggests that the selected contractor was unique, only that the contract was expedient.

National Defence

Unjustified decision that the supplier was unique

This case illustrates the unjustified use of a sole-source contract, based on the unsupported belief that only one source existed. (As noted in the chapter, the most common basis for sole-sourcing is the belief that prior familiarity with a department or program is a sufficient ground for invoking the uniqueness exemption.)

National Defence tested a call-in information service using departmental employees. After a trial period, the Department decided to continue the service under contract with another organization. Initially, two separate contracts were let on a sole-source basis to an outside organization that then retained the services of two retired departmental employees. Obtaining the services of these particular former employees under the contract was explicitly intended, based on their familiarity with the function.

At the end of the first year a single, two-year contract was awarded to the same organization for the services of the same two people. While on contract, they continued to work out of premises in the Department, and used departmental equipment.

The value of the second contract was about \$265,000, so the Department requested PWGSC to let the contract. Acting on the Department's behalf, PWGSC posted an Advance Contract Award Notice. However, the specifications set out in the Notice (with a strong emphasis on very specific experience and knowledge) had to be amended before awarding the contract because one of them could not be met by even the selected contractor. The Notice was not reissued, thereby effectively circumventing the process. Although the Department has informed us that it interviewed the two individuals, we are also concerned that the Department did not document this and hence could not provide sufficient evidence about whether and to what extent the selected individuals met all of the specified experience and knowledge requirements for this contract.

By sole-sourcing this contract, the Department does not know whether there are others who could have delivered the service at the same or lower cost. While some experience or knowledge was likely necessary to do the job, the decision to sole-source denied others who might have had relevant experience the opportunity to bid. The decision also ignored the possibility that other firms or individuals might have been willing to absorb the costs of gaining the necessary knowledge in order to win the contract.

Contract control failures

This case illustrates the failure to recognize that a sole-source contract had ended, and that the contractor was continuing to work under verbal authority. This ultimately resulted in the Department issuing another sole-source contract and making a substantial payment without proper authority.

A contractor was issued a \$1.2 million sole-source contract to carry out a study for National Defence. This contract ran from March 1994 until July 1995, when it ended and the contractor was paid. However, the contractor continued to work on the study without a new written contract or an amendment to the expired contract. In December 1995, the contractor submitted an invoice for \$548,000 for work done after July 1995. The Department does not dispute that the work was actually carried out.

The Department did not have the authority to approve a sole-source contract for that amount of money. Therefore, in February 1996 it requested PWGSC, whose approval levels for service contracts were higher, to assist it by arranging for a retroactive confirming order to be issued. Meanwhile, the contractor continued to work without a written contract. In April 1996, still without a written contract, the Department paid the original invoice of \$548,000. Before the contract could finally be regularized in May 1996, work totalling nearly \$1.56 million had been done for the Department.

This is particularly troublesome as it demonstrates that not only did the Department allow the work to continue but it also knowingly paid the contractor more than \$500,000 before the contract was actually signed.

The Department has informed us that as part of its acquisition reform effort, it is continuing to improve its contracting practices. We will be making further inquiries about this case.

Transport Canada

Unjustified use of an exemption

This is a case in which a contract let on a sole-source basis did not, in our view, meet any of the exceptions under the Government Contracts Regulations.

The Department wanted advice on a significant financial matter and decided to contract for it. We were informed that tentative approaches were made initially to six potential contractors, all of whom indicated their interest. At that point, rather than solicit bids from the various firms, the Department entered into a sole-source contract with one of them for financial analysis. The contract was valued at \$99,994. There was sufficient time to have run a competitive process. Moreover, financial analysis and advice of the type sought are widely available, as the initial contact with the six firms demonstrates.

The justification for sole-sourcing ultimately selected by the Department was essentially that given the nature of the work, it would not have been in the public interest to solicit bids. The work involved in the contract was straightforward financial analysis. Six firms had already been approached for expressions of interest and hence already knew of the Department's intent; inviting bids from only those six firms could have fully met the requirements for competitive solicitation without widening the circle of knowledge. Thus, for both reasons, in our view the standard required to invoke that exception was not met.

Although the Treasury Board Secretariat's Contracting Policy requires that a complete, documented audit trail be kept for contracts, we also found lack of documentation to support major decisions in this case. Without this documentation it was difficult, for example,

for our audit to determine why that contractor was selected, what work the contractor did, when the work was done and whether the contractor was paid in accordance with the terms of the contract. The substantial daily rates that the government paid for the contractor's services (approximately \$3,000 per person per day) would, in our view, have warranted complete documentation to ensure that the government received the services it paid for. The Treasury Board Secretariat's Contracting Policy states that to ensure that the Crown receives good value where competition is deemed not to be practicable, suppliers are to provide price support/ certification. Alternatively, fees should be negotiated on the basis of prevailing rates. The Department was not able to provide any evidence that it had complied with these requirements.

Stages of the Contracting Process

Screening to establish and define the need

26.27 The screening process is the stage at which the decision is made that a service is required. It includes developing a clear statement of what the needed service entails. It is also important at this stage to determine whether the requirement could be met using internal resources instead of a contractor (whether to “make or buy”). We examined the contract files to assess the adequacy of needs analyses, requirement definitions and make-or-buy decisions.

26.28 We found that the files contained only limited information supporting the need for the service to be acquired, no details indicating the relative benefits of make-or-buy decisions and no specific definition of requirements (see Exhibit 26.1). These inadequacies are reflected in some of the problems we observed in our sample of contracts.

Exhibit 26.1

The Screening Process

Number of contracts in our sample of 26 that met or did not meet our criteria for screening.

Criteria	Met	Not Met
The need for the contract was clearly established and the decision to contract was properly authorized	7	19
There is evidence that meeting the needs from internal resources was considered (whether to make or buy).	3	23
A formal request to contract is on file.	25	1
There is a statement of work requirements that is clear with respect to performance, time, service and expected cost.	9	17
The statement of requirements was approved by an appropriate authority.	18	8

26.29 Because there was from the outset no clear definition of requirements — that is, the nature and scope of the tasks to be accomplished — nearly half of these contracts (12 of 26) required frequent amendments that, in many cases, significantly increased their original values. Sometimes the resulting arrangements were not in compliance with the Government Contracts Regulations. Then senior officials had to become involved to correct the problems.

26.30 Managers advised us that one important reason for not conducting make-or-buy analyses was that the shortage of staff after downsizing has in many cases eliminated “make” as an option.

Deciding whether to sole-source

26.31 Section 5 of the Government Contracts Regulations requires that before *any* contract is entered into, the contracting authority *shall* solicit bids (emphasis added). Section 6 of the Regulations outlines four circumstances in which the contract authority may make an exception and enter into a contract without soliciting bids (that is, enter into a sole-source contract). The Treasury Board Secretariat’s Contracting Policy (Section 10.2.2 to 10.2.5)

elaborates on these circumstances and provides clear guidance to managers who may want to use an exception to avoid the necessity of soliciting bids (see Exhibit 26.2).

Exhibit 26.2

Four Permitted Exceptions to Soliciting Bids

The Government Contracts Regulations outline four exceptions; the Treasury Board Secretariat’s Contracting Policy elaborates on these exceptions.

Government Contracts Regulations	Treasury Board Secretariat’s Contracting Policy
Pressing emergency	Emergencies are normally unavoidable and require immediate action. ... An emergency may be an actual or imminent life-threatening situation, a disaster that endangers the quality of life or has resulted in the loss of life, or one that may result in significant loss or damage to Crown property.
Value of less than \$25,000	Specific dollar limit.
Not in the public interest	Should normally be reserved for dealing with security considerations or to alleviate some significant socio-economic disparity.
Only one person (firm) capable of performing the work	Should be invoked only where patent or copyright requirements, or technical compatibility factors and technological expertise suggest that only one contractor exists. This exception should not be invoked simply because a proposed contractor is the only one known to management.

Note: According to the Treasury Board Secretariat’s Contracting Policy, any use of the four exceptions to the bidding requirement should be fully justified on the contract file or, where applicable, in submissions to the Treasury Board.

Source: Government Contracts Regulations (Section 6), and Treasury Board Secretariat’s Contracting Policy (Section 10.2.2 to 10.2.5)

26.32 In Section 10.2.6 of the Treasury Board Secretariat’s Contracting Policy we find the following reference:

Any use of the four exceptions to the bidding requirement should be fully justified on the contract file or, where applicable, in submissions to the Treasury Board. Even if a proposed directed contract...for goods and services qualifies under one of these four exceptions, the contracting authority is encouraged, whenever possible, to use the electronic bidding methodology to advertise the proposed award through an Advance Contract Award Notice (ACAN). If there are no valid challenges to the ACAN after fifteen calendar days, the proposed contract is deemed to be competitive and may be awarded using the electronic bidding contracting authority.

Should the contracting authority have to seek the Treasury Board’s approval to award such a contract, it should be noted that the Treasury Board cannot approve a directed contract which does not meet at least one of the four exceptions. In such cases, an exception to the Regulations by means of an order-in-council would be required.

When a manager believes that one of the exceptional circumstances exists, the onus is on the manager to show why the exception applies to the contract in question. The manager must formally provide written evidence in the contract file to show the justification for the exception.

26.33 When the uniqueness of the source, for example, is invoked as the reason for sole-sourcing, the guidance makes it clear that management’s belief in that uniqueness does not in itself justify the exception. Managers are expected to take positive steps and make inquiries to verify that the source is, indeed, “unique” — that no one else can supply the service. Thus, we expected that the contract files in our sample would clearly identify which of the exceptions had been invoked to justify sole sourcing, and would contain written evidence of the steps management

had taken to verify that an exception was warranted. Exhibit 26.3 sets out in schematic form the logic process that the Government Contracts Regulations require a manager to follow in considering whether a sole-source contract is permissible.

Exhibit 26.3 is not available, see the Report.

26.34 Advance Contract Award Notices (ACANs) are electronic notices posted on what used to be the Open Bidding Service, now called MERX. This system permits a department to post a notice indicating its intent to award a sole-source contract to a particular supplier. If no one comes forward during the 15-day notice period, the contract goes to the named supplier and the contract is considered to be “competitive”, *even though no competing bids have been submitted*. However, using an ACAN does not exempt the department from the requirement to confirm that the sole-source contract qualifies under at least one of the four stipulated exceptions (Exhibits 26.2 and 26.3).

26.35 Although all of the contracts in our sample were awarded on a non-competitive basis, we found that only 8 of the 26 had satisfied one of the necessary conditions that make such awarding permissible (see Exhibit 26.4). Indeed, in most instances it was not even clear from the contract file which exception the manager had invoked to justify sole-sourcing the contract.

Exhibit 26.4

Decision to Sole-Source

Number of contracts in our sample of 26 that met or did not meet our criteria for sole-sourcing

Criteria	Met	Not Met
The decision to sole-source or seek bids is clearly recorded.	26	0
The decision to sole-source is in compliance with the Government Contracts Regulations.	8	18
ACAN use justifiable; based on evidence on file.*	2	5

*19 of the contracts in our sample did not involve ACANs - Advance Contract Award Notice

26.36 We also found that few of the contracts had been advertised using an ACAN, as the policy encourages. Accordingly, too many were awarded without competition. This situation does not reflect the principle of open access to contracting opportunities with the federal government. In our opinion, the awarding of these contracts would not withstand public scrutiny.

26.37 Exhibit 26.5 summarizes the departments’ justification for sole-sourcing in the contract files we reviewed. As it shows, the most common reason for directing the contract to a sole source is “prior experience”. This would imply that departments view a contractor as unique — the only person or organization capable of doing a job — merely by virtue of having had “prior experience”. Although the Regulations set a higher standard for uniqueness of source, not one file that we reviewed showed that the department had taken sufficient reasonable steps to confirm that the proposed contractor was unique in its ability to provide the needed service.

Exhibit 26.5

Reasons Given for Sole-Sourcing the Contracts in Our Sample

Reason	Number of contracts
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Prior experience with program or project.	13
Management does not know of another source.	5
Initial value was under the limit (\$25,000 or \$30,000 depending on the date).	3
Not in the public interest.	3
Other.	2

26.38 Not only does “prior experience” fail to meet the test of uniqueness but, moreover, its persistent use as a justification for sole-sourcing seriously undermines the spirit and intent of the government’s contracting policy. It means that too often the first supplier through the door has an effective monopoly on future business. Used as the basis for sole sourcing, prior experience becomes exclusionary: it precludes others from offering new insights or solutions, or even from competing on price by choosing to absorb the cost of the necessary “learning”. We note that in no instance where “prior experience” had been invoked did we find evidence of any effort to assess the “value” of this experience to the task at hand. Prior experience was considered justification in itself.

26.39 The apparent disregard for the rules surrounding sole-sourcing that we observed in the cases we audited raises the questions “Why is this so?” and “Are the rules unreasonable or too onerous?” The Standing Committee on Government Operations asked these questions in its hearings on sole-sourcing. Addressing this very concern, a senior Treasury Board Secretariat official testified before the Committee as follows:

... So we end up by saying that competition is best and we always strive for competition.

Having said that, why do departments have difficulty in establishing Treasury Board policy? There are a lot of reasons. If you can put yourselves in a departmental perspective or in their shoes for a moment, first of all there is a time constraint. When you go competitive, it is more time-consuming, as a general rule, than if you sole-source a contract.

Costs are involved. Obviously, time is money. If it takes more time, there are costs associated with that. In a lot of cases it’s seen by departments as being an administrative burden. It’s not as quick to get a contract out through the competitive process as it is when you sole-source. They have mutually exclusive sub-objectives. A lot of program managers would like to get the program delivery out but not necessarily be concerned with good contracting procedures.

Also, you need a knowledge base and expertise. So you normally have to have an identifiable contracting organization that has sole responsibility for contracting. That’s sometimes a constraint on departments, especially ones in downsizing mode. There are limited human resources. We’ve had significant reductions in our government’s workforce over the last several years; hence, limited resources are available for this particular activity. You also need trained and knowledgeable individuals. To train and give that kind of experience to human resources obviously creates some constraints. (Testimony, 26 March 1996)

26.40 While testimony before the Committee indicated that departments perceive these rules as constraints, it also pointed out why the rules are in place (for example, to comply with the terms of domestic and international trade agreements). The testimony certainly provided no comfort for a position that the rules imposed *unreasonable* constraints. After weighing all of the evidence, the Committee issued a report that came down fully in support of the rules. It also supported the use of much more stringent procedures — both in departments and in Treasury Board Secretariat — that would force organizations to comply with the rules.

Setting up the contract to provide for best price and value

26.41 Sole-sourcing for services (even when justified) leaves vulnerable the government's goal of receiving best value. In contrast, when bids are sought the preparation of a Request for Proposals requires a clear statement of the nature and scope of the work as well as what is to be delivered. Accordingly, the competitive bidding process provides some degree of assurance that the best value will emerge from among the bids submitted. In a non-competitive situation that lacks these elements, it is important that other processes be followed to ensure best value. For example, we looked in the files for management's detailed statement of the work to be done, along with its estimate of the nature, extent and cost of the work. These would permit management to assess whether the proposal submitted by the sole source was reasonable. We expected that management would have ascertained the "going rate" for the services of similarly qualified individuals or firms and used this information in negotiating the rate for the contract. We also expected to find that (as recommended by Treasury Board) there had been some examination of the selected supplier and its cost estimates and, ultimately, a requirement for the supplier to certify that it was giving the Crown its best rate. Finally, we expected to find that before work began, each contract had clearly set out what was to be done by when and at what cost.

26.42 By and large, we did not find what we had expected. In only 9 of the 26 cases (Exhibit) did we find a fully developed statement of work that included management's estimates of the time and costs to do the work. Often we found that the only detailed statement of work, assessment of time and costs, and definition of deliverables had been prepared by the selected contractor in response to the department's very summary statement of need.

26.43 Generally, departments did not maintain together in one contract file all the documentation required to substantiate the transactions. Departmental officials told us that there were several "contract files" that, taken together, might contain the required documentation. Separate files were maintained in the departments by procurement staff, the responsibility centre managers and corporate finance. In some cases, those files were neither cross-indexed nor available. Generally, the evidence in the files we did see was neither complete nor sufficient for audit purposes. In some cases, the designated responsibility centre manager could not locate any files.

26.44 Treasury Board Secretariat's Contracting Policy states that the terms and conditions of any contract issued should be in writing, and that the contract should be signed by the authorized departmental officials and the representatives of the contractor as soon as possible after notice of the award to the successful bidder. However, we found that departments had entered into many oral contracts, with formal written contracts signed only well after the work had begun and sometimes after it had been completed.

26.45 Without a written contract that specifies the terms and conditions of the work to be done and contains the appropriate signatures, the Crown is exposed to unknown liabilities. Furthermore, our sample indicated that oral contracts may give rise to problems that require extensive involvement by senior departmental and/or Treasury Board Secretariat officials, and sometimes Treasury Board ministers, depending on the size of the contract needing ratification.

26.46 We found only limited evidence in some of the files to support the contractor's price and/or the contractor's certification of best price. The departments were not able to provide any other evidence that the government was receiving good value.

26.47 As Exhibit 26.6 indicates, in only 5 of 26 cases were we provided with reasonable evidence that management had been able to look at the contractor's proposal and assess whether the estimated time and costs were reasonable, given the nature and scope of the work to be done. In only one case were we presented with evidence that management had known the "going rate" and used it in negotiations with the supplier. However, in a fifth of the cases (5 of 26), management had required certification of best price by the supplier. At least in those instances, some assurance was provided on price — if not on value.

Exhibit 26.6

Setting Up the Contract

Number of contracts in our sample of 26 that met or did not meet our criteria for setting up the contract to provide for best price and value.

Criteria	Met	Not Met
The amount of work proposed by the contractor was examined and determined to be commensurate with the intended scope of the work.	5	21
Prices were negotiated based on documented knowledge of the “going rate”.	1	25
Price support or certification was provided by supplier.	5	21

Ensuring delivery in accordance with the terms of the contract

26.48 We examined the contract files for evidence that the contractor had carried out the work in accordance with the contract specifications, on time, and at the agreed cost. Our audit criteria were based on the Government Contracts Regulations and the Treasury Board Secretariat’s Contracting Policy.

26.49 We found that the deliverables — what the contractor did — were generally described in intangible terms (such as “advice”, “professional services”). Most contracts did not specify clearly what service was required and over what time period. In 21 of 26 cases departments were able to provide us with copies of suppliers’ invoices and sign-offs certifying that services had been rendered in accordance with the contract conditions. But other documentation in the files was limited. For nearly two thirds of our sample (17 cases), departments could not provide additional evidence, as stipulated in Section 16.11 of the Treasury Board Secretariat’s Contracting Policy, that the deliverables specified in the contract had been provided in full and on time (see Exhibit 26.7). Consequently, management is unable to provide assurance that services in those 17 cases were rendered according to all the terms of the contracts and that funds were disbursed for the purposes intended.

Exhibit 26.7

Contract Delivery

Number of contracts in our sample of 26 that met or did not meet our criteria for ensuring delivery in accordance with the terms of the contract (14 of the contracts did not involve amendments).

Criteria	Met	Not Met
Certification that the services were delivered as specified in the contract (sign-off under section 34, FAA*) was on file.	21	5
Evidence on file that deliverables specified in the contract were provided at stipulated costs, quality and timeliness.	9	17
Contract amendments were properly justified and approved.	7	5
Contract amendments were in the best interest of the government (e.g. not caused by poor contract planning or established with the intent of contract splitting).	5	7

Amendments can compromise open access

26.50 Amendments were another element of contract management that was of considerable concern to the Standing Committee on Government Operations in its inquiry on contracting. The Committee said that tighter controls were required to ensure that amendments were issued only when truly warranted. It wrote:

Our Committee shares the Treasury Board concern over the large volume of contract amendments. In many cases, the amendments are necessary and justified; in others, cost overruns have occurred as a result of weak project management and poor financial controls. Our Committee believes that tighter monitoring of contract performance should be enforced by Treasury Board and the contracting authority within departments and agencies.

26.51 We examined our sample of contract files for evidence that a duly executed contract had been on file when amendments were made, and that the amendments had been properly justified and approved in accordance with Treasury Board policy. We also assessed whether the amendments were in the “best interest of the government” and were neither the result of poor contract planning nor a means of circumventing other contracting rules.

26.52 As Exhibit 26.7 shows, for about half of the cases involving an amendment, we were provided with insufficient evidence to determine whether or not the amendment had been justified and properly executed. In files that contained enough evidence to make a judgment, for the most part we found that amendments had been neither justified nor properly executed. This often resulted in retroactive changes to contracts. Senior departmental officials, the minister, and sometimes the Treasury Board then had to become involved to rectify, amend, certify and ratify.

26.53 In our opinion, poor planning of procurement, inadequate needs analysis and poor definition of requirements contribute greatly to the often complex and expensive process of changing the original contract. Furthermore, amending contracts instead of soliciting new bids compromises both public scrutiny of the spending of public funds and open access to contracting opportunities for other suppliers.

Conclusion and Recommendations

26.54 In its report, the Standing Committee on Government Operations began its discussion of sole-source contracts by stating firmly that “competition is best”: it has proved to provide the best combination of value and price. The report observed that the proportion of sole-source contracts had been too high for too long, and that the situation had to be corrected. The Committee did not question the rules surrounding sole-sourcing; it called for strict adherence to them.

26.55 Our 1997 Report Chapter 6, Contracting Performance, noted that many of these rules were in place to respond to the government’s legal and treaty obligations in the conduct of its business. It also noted the need to ensure that contracting practices avoid both the substance and the appearance of preference or patronage. As we observed, government contracting “must cope with these additional expectations without being able to use some of the more aggressive — or more co-operative — contracting tactics ascribed to some private sector organizations, and without incurring excessive administrative costs.” We noted that while the rules for government contracting are different, they are consistent with the broader legal and policy obligations that government managers must meet.

26.56 The Treasury Board Secretariat’s Contracting Policy requires that government contracting be conducted in a manner that will:

- 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;

- ensure the pre–eminence of operational requirements; and
- support long–term industrial and regional development and other appropriate national objectives.

26.57 The results of our present audit suggest that these requirements are not being met. The managers entering into these contracts may well have had the view that expedience — “getting on with the job” — was sufficient justification for deciding largely to ignore the rules. But in our view, they did not exhibit the prudence necessary to protect the Crown’s interests when entering into a non–competitive relationship with a supplier. Prudence involves such things as clearly defining what is to be done and the resources that the task ought to consume, having a good knowledge of the “going rate” for the service to be purchased, and requiring certification of “best price” from the supplier. Finally, while the need to “get on with the job” may have been the basis for sole–sourcing many or most of these contracts, we found scant evidence of the “job that got done.”

26.58 In the past, we have made many recommendations to the government for improving contracting practices. Essentially they can be reduced to one: follow the existing rules. That is also the essence of the Standing Committee’s recommendations: their general focus in the areas covered by our audit was on the need for additional controls to try to ensure that government managers follow the contracting rules. Nonetheless, based on our sample, breaking the rules in letting sole–source contracts seems to be widespread. Perhaps this is because it seems to bring few consequences. Introducing new controls over contracting does not seem to be the solution; it would only add to the sense of constraint that many managers feel, and adding steps to the contracting process would increase the time it takes. In turn, some managers would see the added time as added justification for ignoring the rules and “just getting on with it.” The answer may lie in demanding more accountability for the full range of considerations involved in public sector procurement.

26.59 Deputy ministers should ensure that those to whom they delegate contracting responsibilities fully understand the dual objectives of government contracting policy (open access and best value) and are held accountable for adherence to them.

26.60 Deputy ministers should ensure that when contracts are sole–sourced, the circumstances are fully consistent with the provisions of the Government Contracts Regulations.

***Government’s response:** We wish to thank the Office of the Auditor General for this audit of contracting for professional services.*

We are committed to providing departments with leadership to implement sound practices in contracting throughout the federal government. In this regard, we will consider the findings of the audit in our work to improve federal contracting for services.

***National Defence’s response:** Policies currently in place within the Department of National Defence clearly reflect the government’s dual policy objectives of providing open access to, and obtaining best value from, the contracting process. These policies have recently been reviewed and requirements will be reconfirmed in the very near future. The new policy statement will re–emphasize that sole–source contracts must fully conform to the requirements and circumstances detailed in the Government Contracts Regulations.*

In addition to policy statements, departmental training programs already exist to ensure that individuals delegated contracting authority fully understand their duties and obligations. In National Defence, contracting authority is not delegated until such training has been successfully completed.

As a final point, this Department is concerned that the limited sampling technique employed in the conduct of this audit has led to conclusions that may not be representative of department–wide contracting practices. It is

acknowledged that sole-source contracts represent a potentially contentious area of contracting, but it remains the intent of this Department to consistently and uniformly apply existing regulations throughout the process.

About the Audit

Objective

The objective of our audit was to examine compliance with the rules for contracting in a sample of sole-sourced contracts for professional services selected from five departments, and to report to Parliament on the results of that work.

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 in Appendix B of this chapter. We used the criteria to assess information derived from:

- an analysis of the provisions of the policy itself, focussing on the Treasury Board Secretariat policy documents together with those of Public Works and Government Services Canada and five other departments;
- 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, and five 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, in addition to:

- review and analysis of the government's contracting and public accounts data;
- analysis of documents provided by, and discussions held with, officials in Correctional Service Canada, Fisheries and Oceans, Health Canada, National Defence, and Transport Canada; and
- analysis of more than 45 professional service contracts presented in 26 cases, for which five departments made payments totalling \$16 million.

To choose the cases, we asked the departments to provide lists of sole-source contracts let in 1996 in amounts over \$25,000 for professional services that were non-material in nature. From those lists we selected up to 10 cases in each department and vetted them to ensure that they met our selection criteria. In each department, the intent was to select the first five cases that met the criteria. Ultimately, we looked at four cases in one department, six cases in each of two departments and five cases in each of two other departments, for a total of 26 cases.

The audit did not assess either the performance or the qualifications of the suppliers. No comments in the report should be construed as criticism of the suppliers.

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Appendix A

Government Contracting, Report of the Standing Committee on Government Operations — Extract

April 1997

I. Introduction

The Standing Committee on Government Operations has been examining the various aspects of government contracting for goods and services within the federal jurisdiction over the last two years. As a Standing Committee of the House, it saw the need to assure Parliament that government contracting is competitive; is accessible to all sizes of business in all regions of Canada; and that it is managed and operated by officials with due regard for economy, efficiency and effectiveness. As a consequence, this means that goods and services contracted out to Canadian businesses in all regions of Canada by the Government of Canada must reflect, among other things, the most economic price, value for money, the efficient delivery of services, and the realization of the Government's financial and budgetary goals.

Our Committee has noted in a recent Treasury Board report that approximately \$8.6 billion was spent by the Government of Canada in fiscal year 1994-95 on contracting activity. Of this amount, over \$3.2 billion (or 37%) for that fiscal year was for sole source or non-competitive contracts. This has been a major concern for the Treasury Board and our Committee and contrary to the government's contracting policy to encourage competition, easier access to government business, fairness and transparency in the contracting process. Our Committee therefore undertook to examine this.

To undertake this study, our Committee invited expert witnesses from federal government departments and agencies, business, labour unions and academic. Over a two-year period, 39 hearings were held; and over 68 briefs and papers were received.

The study was divided into three phases: in the first, our Committee considered the wide scope and definition of contracting in the public sector which in turn led to the identification of several problems and concerns in government contracting in the federal system. The second phase examined the competitiveness or non-competitiveness of government contracting, sole source contracts, the Open-Bidding Service, and the problems relating to small and medium-sized enterprises (SME'S) contracting with the Government of Canada. In the third phase, our Committee challenged the Government with some early findings and recommendations, and subsequently received some favourable and positive responses. As a result, much progress has been made by the Government to improve the government contracting process and introduce new measures in departments and agencies to reduce and control spending in government contracting.

With this report, our Committee recommends further action to be taken by the Government to improve the government contracting process.

II. Summary of Major Conclusions

1. Much progress has been achieved by the Government in improving its contracting policies, procedures and practices over the last two years through our Committee's action and greater public awareness. However, there is much more to be done as reflected in the conclusions that follow.
2. The Treasury Board is not enforcing its policies, directives and guidelines for the approval and execution of contracts by departments, agencies and Crown corporations that fall within its jurisdiction.
3. There is a general lack of public awareness of the federal government's contracting process in many sectors of the Canadian economy, including the small and medium-sized enterprises (SME's) as well as a general lack of understanding of how to access it.
4. The Open-Bidding Service (OBS) does not serve adequately the needs of both the private and public sectors; for many firms, there are difficulties of access, cost, transparency and fairness; for many government departments and agencies, it is more economic and efficient to select bidders on a competitive basis from their respective specialized source list of contractors and suppliers.
5. There is an over-proportionate volume of awards of sole source contracts by departments and agencies, thereby reducing competition in the private sector for government business.
6. There is an increasing use of contract amendments in most government departments and agencies which has led to unnecessary cost overruns.
7. The Government does not have an adequate database for government contracting that can serve both the public service management needs and Parliament.
8. The annual reporting by the Treasury Board Secretariat (TBS) of contracting activity in government departments is inadequate and not timely for parliamentary review.

III. Summary of Recommendations

1. The Standing Committee on Government Operations recommends that TB contracting policies be strengthened and enforced in the following ways:
 - (a) contractors/suppliers be paid no later than 30 days after billing (now implemented);
 - (b) the cut-off for non-competitive contracts be reduced from \$30,000 to \$25,000 (now implemented);
 - (c) it should be mandatory that all such contracts over \$25,000 be open to competitive bidding on the OBS, subject to the exceptions already outlined in TB policy;

- (d) exceptions must be reviewed with the aim of reducing the number of times they are used to bypass the competitive process;
- (e) strong sanctions be imposed to prohibit “contract splitting”;
- (f) TBS should ensure that all departmental managers and appropriate staff have the necessary knowledge and training in contract administration so that government contracting policies and practices are well understood and executed by all;
- (g) the drafting of contract requirements must avoid “contract tailoring”;
- (h) that TBS and PWGS Canada draft a Code of Conduct or a Code of Past Practice for government contracting, and establish contract review mechanisms or boards in each agency.

2. Our Committee recommends an initiative called “Contracts Canada” be created within PWGS Canada to:

- (a) heighten awareness and access for small and medium-sized enterprises (SME’s) interested in learning how to do business with the federal government;
- (b) act as an office of inquiries for businesses who have problems with the contract bidding process or need more detailed information about government contracting;
- (c) consider establishing an office of an ombudsman (similar to that of the banking industry) for dealing internally and independently with specific contract problems experienced by private businesses and government agencies;
- (d) launch a public awareness campaign across Canada to inform businesses (including SME’s) how to get involved in government contracting;
- (e) advertise the rotation system currently in place to inform all businesses how to get on the source lists of federal departments and agencies;
- (f) to simplify and/or decrease the paperwork involved in government contracting procedures and practices.

3. Our Committee recommends that the current Open-Bidding Service (OBS) be completely revised to improve access, competition, transparency and fairness and that the specifications for the new OBS in 1997 take into account improvements in the following areas:

- (a) the continual need to reduce costs and subscriber fees for businesses (particularly SME’s) to compete for government contracts;

- (b) bid solicitation information should be packaged more concisely and efficiently to avoid wasting time and the scarce resources of bidders;
- (c) choice of service levels needs to be increased through improved electronic bid sets, better database search software and lower telecommunications costs;
- (d) partnerships with other database access services should be entered into to offer suppliers a choice of other value-added service offerings;
- (e) cheaper alternative electronic means for advertising government contracts to a wider clientele should be continually upgraded to take advantage of technological improvements and to reduce costs.

4. Our Committee recommends that:

- (a) Treasury Board ensure that all sole source contracts, prior to approval, be examined by contract review mechanisms or boards within each department and agency to ensure that competition, access, transparency and fairness are being promoted;
- (b) all cases of exceptions or non-compliance with the Government Contracts Regulations be reported back to the TBS and the Auditor General; and
- (c) the Auditor General conduct periodic audits in those departments and agencies where sole source contracts are awarded regularly on an exception basis or where there has been non-compliance with the Government Contracts Regulations.

5. Our Committee recommends that:

- (a) Treasury Board request all departmental heads to establish a senior management committee to review all contract amendments within their jurisdiction and to monitor more closely the activities giving rise to such amendments;
- (b) where justified, contract amendments should be broken down into sub-categories — e.g. cost overruns, legitimate contract add-ons etc. — in order to reduce significantly unnecessary cost overruns;
- (c) these amendments sub-categories should have varying tolerances set by Treasury Board. Ten percent is recommended as a guideline for specific cost overruns.

6. Our Committee recommends that the Treasury Board:

- (a) in conjunction with PWGS Canada and other departments, continue to improve a standardized reporting framework so that an accurate database for all contracting activity in the government will be established;

- (b) place a high priority on eliminating information gaps in government contracting activity by requesting data from departments on competitive and non-competitive contracts, sole source contracts, contract amendments and justifications;
- (c) place a high priority on issuing an annual report to Parliament on government contracting activity on a timely and regular basis.

Final Recommendation

Our Committee recommends that the Government implement all the above recommendations and report on the progress of implementation to the Chair of the Committee before March 31, 1998.

Appendix B

Criteria and Results Indicators for Contracting

The criteria that we applied are set out below, together with the supporting subcriteria and quantitative results indicators considered. They were developed during our 1997 audit of contracting performance (1997 Report, Chapter 6), reviewed with managers and other stakeholders, and agreed to by Treasury Board Secretariat and Public Works and Government Services Canada.

Criterion	Subcriteria	Results Indicators
<p>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.</p>	<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)
<p>Competition. The extent to which competition (when used) is open, fair and gets good value.</p>	<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
<p>Delivery. The extent to which government contracting delivers what was agreed, when it was agreed, and for the price agreed.</p>	<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

Chapter 27

Grants and Contributions

Selected Programs in Industry Canada and Department of Canadian Heritage

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Grants and Contributions

Selected Programs in Industry Canada and Department of Canadian Heritage

Main Points

27.1 The Office of the Auditor General considers the proper management of grants and contributions to be an important part of good public administration within the federal government. Accordingly, the chapter presents:

- an overview of the use of grants and contributions by departments;
- highlights of the Office's observations over the past 21 years on the value for money in grant and contribution programs;
- a performance management framework that we are developing for grant and contribution programs; and
- the results of an audit, using aspects of this framework, of selected grant and contribution programs in Industry Canada and Canadian Heritage.

27.2 Our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations: problems in compliance with program authorities, weaknesses in program design, instances of poor controls, and insufficient performance measurement and reporting. Overall we have continued to find the same problems. There are many reasons why these problems have persisted. They range from decision-makers not following the rules governing expenditures on grants and contributions to weak management practices. To address this latter problem, our Office is developing a performance management framework.

27.3 We found that there are significant opportunities to improve the management of the programs we audited:

- For the Ontario Base Closure Adjustment Program delivered by Industry Canada, there was little evidence that the Department exercised due diligence in approving funding for many projects.
- We had similar concerns about Canadian Heritage's Multiculturalism Program. In about one third of the projects we audited, there was little evidence that the Department had exercised due diligence in approving funding. We are also concerned that the Program's performance expectations are ambiguous; clarification is needed to avoid duplicating the efforts of other departments and of provincial governments.

27.4 We also examined indirect delivery arrangements where a department contributes funds to an external organization that, in turn, distributes funding to the intended recipients. These arrangements require special accountability measures since departmental managers cannot rely on direct supervision and adjustment to achieve expected results. We found that Industry Canada could strengthen accountability for performance under its contribution agreements with CANARIE Inc. (Canadian Network for the Advancement of Research, Industry and Education) and PRECARN Associates Inc. (Pre-Competitive Advanced Research Network).

Introduction

27.5 The provision of grants and contributions to individuals, businesses and not-for-profit organizations is one of the most important ways that the Government of Canada pursues its program objectives.

27.6 Accordingly, the chapter presents:

- a brief overview of the Office's observations over the past 21 years on value for money in grant and contribution programs;
- a performance-oriented management framework that we are developing for grant and contribution programs and that we will use again in future audits; and
- the results of an audit, using aspects of this framework, of selected grant and contribution programs in Industry Canada and Canadian Heritage.

An overview of grant and contribution programs in the federal government

27.7 Grants and contributions are part of the category of expenditures known as transfer payments. Transfer payments are transfers of money from the federal government to individuals and to organizations of various types, including businesses or other governments.

27.8 Grants are unconditional transfer payments for which eligibility and entitlement may be verified. If an individual or organization is eligible for a grant, the appropriate payment can be made without requiring the recipient to meet any future conditions. In contrast, the payment of a contribution is subject to performance conditions that are specified in a contribution agreement. The recipient must continue to show that these conditions are being met in order to be reimbursed for specific costs over the life of the agreement. The recipients' use of contributions can also be audited by the government, whereas this is usually not a requirement for a grant.

27.9 Because there is generally less accountability required for grants, we have argued for many years that they ought to be reserved for situations where they are truly unconditional or where they can be administered more cost-effectively than contributions.

Planned spending for 1998-99

27.10 The Main Estimates and Supplementary Estimates A for 1998-99 indicate planned spending of \$39.5 billion on grants and contributions by departments and agencies, \$23.1 billion of which are grants made by Human Resources Development Canada. (See Appendices A and B for a summary of planned expenditures on grants and contributions by all departments and agencies.) This total spending includes both statutory and voted (or discretionary) expenditures. Statutory expenditures are those that have been given continuing authority by acts of the current or previous parliaments and therefore require no new parliamentary approval. Voted expenditures are those for which parliamentary authority is sought through an annual appropriation act.

27.11 This chapter addresses issues surrounding the management of voted grants and contributions and not statutory ones, over which managers have little discretion.

Selected observations in previous audits

27.12 We have reported to Parliament on numerous audits of grant and contribution programs over the past 21 years. Many of those audits identified similar concerns. What follows is a brief discussion of the key messages of those audits.

27.13 Government-wide. In 1977, we reported on a two-year review of grant and contribution programs of 20 departments and agencies. Our observations fell into four broad categories:

- inconsistent application or interpretation of government policy on grants and contributions;
- inefficient use of funds and inadequate measures to ensure accountability by program recipients;
- lack of control, monitoring and evaluation; and
- reporting in the Estimates and the Public Accounts that was inadequate to facilitate examination and year-to-year comparisons by Parliament.

27.14 In 1984, as guidance to audit staff, we identified eight critical management processes for grant and contribution programs:

- stating objectives clearly;
- establishing unambiguous terms and conditions;
- informing potential applicants of program guidelines;
- reviewing and approving applications diligently;
- making payments properly;
- monitoring individual grants and contributions appropriately;
- providing good information to management; and
- assessing program effectiveness.

These processes became the basis for subsequent value-for-money audits during the 1980s.

27.15 Department of Regional Industrial Expansion. In a 1985 audit of the direct assistance programs of the Department of Regional Industrial Expansion, we reported a number of weaknesses in control processes and program delivery practices. We recommended documented assessment guidelines and controls to ensure that project approval processes across the country were consistent and that funded projects met program eligibility requirements and objectives. We also recommended that departmental guidelines on assessing the need for support be strengthened and that the analyses of selection criteria be part of the case file documentation. In 1987, we followed up on the status of these recommendations. Although the Department had strengthened many of its procedures, aspects of project eligibility continued to be a problem and more specific guidelines for determining eligibility still did not exist.

27.16 Canada Employment and Immigration Commission. In 1986, as part of an audit of the Canada Employment and Immigration Commission, we suggested that because grants require no monitoring of recipients' performance, their use ought to be minimized. We recommended that departments and agencies be authorized to use this funding mechanism only where it can be clearly demonstrated that it is a more cost-effective way of achieving program objectives.

27.17 Indian Affairs and Northern Development. In 1988, as part of our audit of the Department of Indian Affairs and Northern Development, we reported ongoing concerns about the implementation of contribution agreements with Indian bands and organizations. These long-standing concerns were in two main areas: the release of funds before complete documentation requirements had been satisfied, and inadequate monitoring of band operations to ascertain whether funds were being spent for the purposes intended. We recommended, among other things, the development of a financial policy framework that encouraged good management of funding arrangements.

27.18 Secretary of State. In our 1990 audit of Citizenship Development Programs of the Department of the Secretary of State, we identified the need to establish criteria for evaluating applications and results against program objectives. This was consistent with earlier observations concerning the need for departments to put more effort into monitoring and assessing program results.

27.19 Industry, Science and Technology. Also in 1990, we reported instances where the Department of Industry, Science and Technology had not exercised due diligence. Our work uncovered cases where projects were approved despite initial departmental analysis indicating that they did not meet eligibility criteria. We also observed cases where the financial support to a project was more than departmental analysis identified as necessary. Little or no documented rationale was available to explain these decisions.

27.20 Fisheries and Oceans. Our 1993 audit of the Northern Cod Adjustment and Recovery Program administered by Fisheries and Oceans revealed some significant weaknesses. We reported the lack of a clear legislative authority to deliver the program, significant difficulties in targeting payments to those closely affected by the moratorium on fishing northern cod, payments to individuals who did not meet eligibility requirements, and weak financial management and controls. We recommended clarification of the legislative authority for the program and consequential amendment of the terms and conditions and administrative procedures.

27.21 Industry Canada / regional development agencies. In 1994 and 1995, we audited a number of contribution programs delivered by Industry Canada and by the federal regional development agencies (Atlantic Canada Opportunities Agency, Federal Office of Regional Development-Quebec and Western Economic Diversification Canada). We noted weaknesses in different aspects of program delivery, including lack of due diligence in project assessment. Our recommendations included:

- more persuasive assessments to support funding decisions, and documentation that reflects all the major factors supporting decisions to approve assistance;
- the streamlining of guidelines and criteria for assessing applications, differentiated by size and risk, and simplification of application documentation for small projects;
- better co-ordination with other federal and provincial departments in view of the potential for duplication of effort and funding; and
- greater attention to collecting repayable contributions.

27.22 In summary, our audits of the management of grant and contribution programs over the past 21 years have produced a long series of consistent observations. Our 1977 audit found problems in compliance with program

authorities, weaknesses in program design, instances of poor controls, and insufficient performance measurement and reporting. Subsequent audits have made similar observations. While we have found signs of specific improvements in some areas when we followed up on these audits, overall we have continued to find the same problems each time we have audited grant and contribution programs.

27.23 An obvious question is why have these problems persisted? There are, of course, many reasons, some of which have to do with situations where decision-makers simply have not followed the rules governing expenditures on grants and contributions. There are other reasons, however, having to do with weak management practice. In particular, setting clear, attainable goals, exercising due diligence and measuring performance have continued to be challenges for program managers. Accordingly, our Office is developing a performance management framework for grant and contribution programs that we hope will help managers manage better.

A performance management framework: helping managers manage better

27.24 We are developing the framework for several reasons:

- It provides us with a way of summarizing our views on good management of grant and contribution programs, based on more than 20 years of value-for-money audit work in this area.
- It sets out our expectations of management — in other words, what we will be looking for in future audits of grant and contribution programs.
- Perhaps most important, it is designed to help departmental managers think critically about their programs and consider how best to manage them.

27.25 Exhibit 27.1 shows an initial list of the qualities of a well-managed grant or contribution program. Each quality is a product of a well-designed management system and of good practices. In fact, these qualities correspond closely to the key controls we have looked for in previous audits. In the framework, we hope to encourage managers to move beyond control in and for itself to a broader view of performance. The qualities also embody the key principles of accountability, the criteria for performance reporting, and the elements of the framework for managing for results recently developed by our Office.

Exhibit 27.1

Qualities of a Well-Managed Grant or Contribution Program

- The choice of funding instrument - grant or contribution - respects accountability to Parliament and achieves a balance among principles of cost-benefit, risk management, and reasonable treatment of program recipients.
- Management can explain how recipients are expected to benefit from funding and to what end.
- Program officers understand who and what is eligible for funding, under what conditions funding can be provided, for what purposes, and in what amounts.
- Potential applicants are aware of the program.
- Eligible projects represent value for money to both the applicant and the program.
- More deserving recipients are funded and at an appropriate level.
- Funding is used for the purposes agreed.
- Problems with project and program performance are resolved quickly.

- Management reporting demonstrates a good knowledge of program performance.
- Money owed to the Crown is collected promptly (in the case of repayable contributions).

27.26 The performance management framework complements existing Treasury Board policies and previous statements by our Office on the management and control of grants and contributions. It does not attempt to replace or repeat them.

27.27 We intend to continue developing this framework and will present it in a future report along with guidance for program managers on risk assessment.

Focus of the audit

27.28 The focus of our audit was to determine whether there were significant opportunities to improve the management of specific programs in Industry Canada and Canadian Heritage. The audit also provided us with the opportunity to apply our performance management framework for grant and contribution programs.

27.29 In particular, this audit brings attention to what constitutes due diligence in assessing applications for grants or contributions. In our view, the assessments supporting decisions to make grants and contributions need to be as thorough as the circumstances require and they need to be documented so that subsequent review and performance measurement is possible. Due diligence does not imply exhaustive analyses in all cases; it simply means ensuring that funding decisions take all of the criteria set by the Treasury Board and a department into account and that they are based on reliable information.

27.30 We selected programs for audit that deal with economic and social development issues — Ontario Base Closures Assistance Program and the Multiculturalism Program respectively. These programs are delivered by departments directly. We also selected examples of indirect delivery — Industry Canada's contribution agreements with Canadian Network for the Advancement of Research, Industry and Education (CANARIE) and Pre-Competitive Advanced Research Network (PRECARN) since this approach is becoming increasingly common.

27.31 Further details on the audit are found at the end of the chapter in the section **About the Audit**.

Observations and Recommendations

DIRECT DELIVERY OF GRANT AND CONTRIBUTION PROGRAMS

Industry Canada: Contributions Under Ontario Base Closure Adjustment Program (OBCAP)

27.32 In 1994, the government announced the closing of a number of military bases across Canada. A federal strategy was prepared, assigning responsibilities to several departments to help communities affected by the closures.

27.33 In Ontario, bases in North York, Ottawa and London were to be closed while those in North Bay and Kingston were to be reduced in size. As part of the government’s strategy, Industry Canada is responsible for providing advice to affected communities and for managing the Ontario Base Closure Adjustment Program (OBCAP), which funds initiatives for economic development and diversification. The base in London involves the transfer of lands to an Aboriginal band and is not included under OBCAP.

27.34 The objective of OBCAP is to help affected communities deal with the economic impacts of military base closures. The program is aimed at helping communities undertake studies of economic development opportunities and implement economic development measures. To be eligible for support under OBCAP, proposed projects must have the potential to address the economic development needs of affected communities and must have broad community support. The Treasury Board requires that potential projects be assessed on the basis of the following criteria:

- degree of community support;
- degree of innovation in the project;
- degree of risk in the project;
- likelihood that the project would not proceed without federal support;
- potential short-term and long-term benefits of the project; and
- cost efficiency and effectiveness.

27.35 OBCAP was given a budget of \$11.7 million for projects over seven years. Exhibit 27.2 shows the allocation of the budget. As of September 1998, there was about \$945,000 left to be disbursed over the next three years.

Exhibit 27.2

Allocation of Budget for Ontario Base Closure Adjustment Program

Community	Allocated Amount
Downsview, North York	\$ 2,100,000
Kingston	\$ 500,000
North Bay	\$ 7,000,000
Ottawa	\$ 2,100,000

27.36 We audited 9 of the 19 projects that had been approved between February 1995 and June 1998. These 9 projects represent about 88 percent of the total dollar value of approvals for the whole program.

Weak assessment of projects

27.37 We expected that the Department’s files would at least contain an assessment against the criteria set by the Treasury Board justifying the decision to fund each project. However, we found little information on file to indicate

that these criteria had been considered in the decision to fund several of the projects we reviewed. In particular, there was little evidence that in these cases Industry Canada officials had assured themselves that the projects represented value for money. Exhibit 27.3 provides examples of two such projects.

Exhibit 27.3

Examples of Lack of Project Assessment Against Funding Criteria – OBCAP

In our view, due diligence demands that Industry Canada officials determine whether proposed projects represent value for money to both the applicant and the program by assessing them against the criteria set by the Treasury Board for the Ontario Base Closure Adjustment Program (OBCAP). The following cases are examples of projects for which there was little evidence on file that such an assessment was done.

CASE 1 — United–States Custom Pre–clearance Facility, Ottawa International Airport

Contribution Amount: \$2,000,000 - Non–repayable contribution - 72 percent of the eligible costs.

Status: Project completed in July 1997.

Description: The project involved construction of a temporary U.S. Customs and Immigration pre–clearance facility within the existing air terminal building.

Background: The application for a \$2,000,000 contribution was submitted by a not–for–profit organization, the MacDonald–Cartier Airport Authority, in November 1996. The agreement for OBCAP funding was signed in January 1997. One month later, the Ottawa International Airport was leased out by Transport Canada to the Authority as part of a decision to lease out major Canadian airport operations.

We found that:

- there is little explanation of how this project contributed to the objectives of OBCAP; and
- there is little information on file indicating that the Department assessed the project against the program funding criteria set by the Treasury Board.

It must also be noted that this project received 95 percent of the total budget that was allocated to Ottawa.

CASE 2 — Construction of a Cultural Centre, Scarborough, Ontario

Contribution Amount: \$ 500,000 - Non–repayable contribution - 50 percent of the eligible costs.

Status: Project completed by March 1998.

Description: A not–for–profit corporation constructed a cultural centre. Under the contribution agreement, the \$500,000 could be used for any costs associated with building or equipping the centre.

Background: In September 1996, the not–for–profit corporation applied to OBCAP for a \$500,000 contribution. The total cost of the project was estimated at \$15 million, spread over three phases. The closed base, CFB Toronto, was located in North York; the project was in Scarborough.

We found that program managers had concerns about this project, and, in particular, had no information demonstrating that:

- the closure of the base in North York had an impact on Scarborough; and

- the project in Scarborough would have an economic impact on North York.

As well, there is little information on file indicating that the Department assessed the project against the program funding criteria set by the Treasury Board to determine whether the project represented good value for money.

Despite the recommendation by senior departmental officials that the project not receive any funding under OBCAP, the Department approved the \$500,000 contribution. The rationale on file for this decision was that there would be some economic benefits to the Greater Toronto Area.

Contributions often exceed recommended limits

27.38 The program terms and conditions state that contributions to studies will not exceed 90 percent of the eligible costs, and contributions to economic development projects will not exceed 50 percent. The merit of the proposal and the ability of the applicant to share the cost determine the level of support. The Minister may, in extraordinary circumstances, decide to contribute up to 100 percent of the eligible costs.

27.39 Five of the nine projects that we audited had received funding that exceeded the stipulated levels. In our view, due diligence would have required that departmental officials assess the extraordinary circumstances that necessitated the higher funding levels. For four of these projects, however, there was no explanation on file to support the decisions to exceed the stipulated level of funding.

Performance information on projects needs to be obtained

27.40 Little information so far on project results. Although the Department's review of the support for claims from recipients was adequate, we found no reports in the files of visits to the sites of the larger projects we looked at. To date, final reports have been prepared for two projects. Those reports included information on the work that was done according to the terms of the OBCAP agreement, but provided no information about the fulfilment of the program objectives and criteria.

27.41 Repayment. The program terms and conditions state that assistance will be subject to the government policy on repayment. However, because similar adjustment programs for base closures across the country did not require not-for-profit organizations to repay the contribution, Industry Canada provided the same exemption under OBCAP.

27.42 Two of the files we audited involved projects through which the applicants, not-for-profit organizations, would realize significant revenues. In our view, there could be merit in the Department considering whether to exempt organizations from repayment on a case-by-case basis after assessing the likely benefits of the project to the applicant.

27.43 Industry Canada should ensure that the projects it funds in its contribution programs represent value for money to both the applicant and the program. In particular, the Department should apply the respective terms and conditions approved by the Treasury Board for its grant and contribution programs when assessing applications for funding. The Department should document this assessment to provide proper justification for the decision to fund or not fund the project.

Department's response: The Department agrees with the Auditor General on the need to better document project files to demonstrate that the projects comply with the approved terms and conditions. We agree that better application of existing documentation processes in the future will demonstrate that all program terms and conditions are respected.

Department of Canadian Heritage: Grants and Contributions Under the Multiculturalism Program

27.44 The Multiculturalism Program has the mandate “to strengthen Canada by fostering an inclusive society in which people of all backgrounds, whose identities are respected and recognized as vital to the evolving Canadian identity, feel a sense of belonging and attachment to this country.”

27.45 In 1997, the Department introduced changes to the Multiculturalism Program; it revised the objectives and decided to eliminate sustaining funding (funding of an organization’s ongoing program of activities, including operational costs) over a three-year period. This funding is being replaced by funding of specific projects that support the program’s objectives and priorities.

27.46 In 1997-98, the Department made grants or contributions totalling \$19 million to 1,000 projects under the Program. We audited a sample of 80 grants and contributions authorized between 1 April 1997 and 31 March 1998.

Performance expectations are ambiguous

27.47 The five objectives of the Multiculturalism Program are stated in very general terms (see Exhibit 27.4). While this is not unusual, the Department has not supported them with more clearly stated and focussed goals and expected results. Doing so would have helped to ensure an appropriate choice of projects for funding and to facilitate measurement of the results achieved.

Exhibit 27.4

Multiculturalism Program Objectives

1. Assist in the development of strategies that facilitate the full and active participation of ethnic, racial, religious and cultural communities in Canada.
2. Facilitate collective community initiatives and responses to ethnic, racial, religious and cultural conflict and hate-motivated activities.
3. Improve the ability of public institutions to respond to ethnic, racial, religious and cultural diversity by assisting in the identification and removal of barriers to equitable access and by supporting the involvement of these communities in public decision-making processes.
4. Encourage and assist in the development of inclusive policies, programs and practices within federal departments and agencies so that they may meet their obligations under the *Canadian Multiculturalism Act*.
5. Increase public awareness, understanding and informed public dialogue about multiculturalism, racism and cultural diversity in Canada.

Source: Department of Canadian Heritage

27.48 We found that with only such broad objectives to guide decision making, the Program is funding projects that also fall within the mandates of other departments or of provincial agencies. For example, our sample included the following projects:

- an anti-drug program for adolescents in a particular religious group;
- integration services for new immigrants;
- a promotional tour for a novelist;
- a brochure on alternatives to physically disciplining children, published in 16 languages including French and English;

- a conference to discuss promoting science and technology programs in schools, for a specific racial group; and
- a conference for Aboriginals on adolescent issues.

27.49 Each of these projects has merit in its own right. However, given the issues they address, these projects appear more directly related to the mandates of other federal departments or of provincial or local social services. We found in some of these projects that other departments or provincial services were working directly with the recipient organization, while Canadian Heritage provided most or all of the project funding. There was no information on file explaining why, given the involvement of these other agencies, the Multiculturalism Program was funding the project.

27.50 We understand that the Program encourages partnership in addressing multiculturalism issues. Nevertheless, in our view, the Department needs to ensure that the broad program objectives are supported by sufficiently clear goals and funding priorities and by good practices to ensure that collaboration on projects does not lead to duplication of effort with other federal or provincial agencies.

Concerns about support for funding decisions

27.51 Due diligence requires program staff to assess applications for funding using the eligibility criteria set by the Treasury Board as well as departmental guidelines (see Exhibit 27.5). In our sample of 80 projects, we found a wide range of practices. Many files contained only partial assessments, while others presented full and persuasive ones. See Exhibit 27.6 for two specific examples.

Exhibit 27.5

Multiculturalism Program Eligibility Criteria

To be eligible, all proposals must meet the criteria as listed below:

- Clear objectives and expected outcomes
- A plan to assess the impact of the project and measure its results
- A detailed budget including:
 - an explanation of the need for Multiculturalism funding;
 - a description of how funding will be used; and
 - a listing of financial and resources from other sources
- Involvement of those individuals, or groups, most affected by the activity
- Involvement and assistance of key stakeholders
- A plan to distribute and share knowledge

Source: Department of Canadian Heritage

Exhibit 27.6

Range of Practice in Exercising Due Diligence - Multiculturalism Program

In our view, due diligence demands that Canadian Heritage officials determine whether proposed projects represent value for money for applicants to carry out and for the program to fund by assessing them against criteria set by the Treasury Board and departmental guidelines. The following cases are examples of the wide range of practice we found in our sample of funded projects.

CASE 1 - Program Objective: Full and Active Participation of All Communities

Grant Amount: \$65,000

Mission of the Organization: The project involves a charitable organization whose mission is “to build strong kids, strong families, strong communities through involvement in programs that develop spirit, mind and body”.

Description: The project aims at the development of strategies for minority participation and leadership in a local public housing area, with special focus on minority youth.

There is evidence that due diligence was exercised in assessing this case because:

- the need for the project is well described;
- there is an explanation of how the project links to the Multiculturalism Program objectives; and
- expected results are identified and supported by clear plans.

CASE 2 - Program Objective: Public Education

Grant Amount: \$10,000, paid December 1997

Recipient Organization: A partnership of community groups

Description: A conference on racism to be held by 31 March 1998

We believe that due diligence was not exercised in assessing this project. While an extensive analysis should not be required for a small grant, we did expect that there would be minimal information on certain key matters. Instead, we found that:

- there was no information on file explaining the specific local problem that would be addressed;
- there were no clear goals or expected results for the conference;
- there was no explanation of why a conference was an appropriate approach; and
- there was no explanation of why program funding was needed for the project to proceed.

27.52 The Department’s guidelines stipulate that every project considered for funding be clearly linked to:

- the mandate of the Multiculturalism Program;
- one or more of the policy goals; and
- one or more of the objectives, as well as priority issues.

27.53 We found that the justification for funding sometimes referred to the policy goal only, and other times only to the objectives or to the activity type; in still other instances, there was no reference at all to any of these elements of the management framework. In addition, no priority issues were developed for 1997-98, and the Department has not yet approved priorities for 1998-99 to 2000-01.

27.54 In about 30 percent of the files we audited, we could not assure ourselves that departmental officials had exercised due diligence in assessing the project. This is because there was little evidence of a reasonably complete assessment of either the merits of the projects or the rationale for departmental support, or both. For example, we found that for many projects, there was little information on file to indicate:

- the specific, local, social development issue that the project was supposed to address;
- why the proposed project was a reasonable way of dealing with the issue; and
- why program funding was needed for the project to proceed.

27.55 In addition, we found many projects for which the expected results were not stated in measurable terms or simply indicated the activity to be carried out, such as “hold a workshop” or “prepare a strategy”. There was often no description of what these activities were expected to accomplish.

27.56 The Program guidelines stipulate that the following kinds of activities are supposed to be excluded from funding:

- regular annual general meetings of an organization or association;
- projects that have already been initiated before an application is made;
- profit-making activities for commercial gain; and
- provision of individual counselling.

We found one or more projects that could be examples of each of these.

27.57 In short, we found that management has not ensured that the assessment process is rigorous and that funded projects demonstrably support the Program objectives and respect its terms and conditions. At the same time, management must meet its responsibilities without requesting more information from applicants than is needed, given the relatively small amounts of some of these grants.

Slow transition to project-specific funding

27.58 As already noted, Canadian Heritage plans to eliminate sustaining funding for organizations and move to project-specific funding. The transition is supposed to take place gradually over the three years ending 31 March 2000. Recognizing that some client organizations might find it difficult to move to a new form of funding, the Department planned to work separately with each organization to develop transition plans by the end of November 1997. However, it did not meet that deadline. For a third of the applicable cases, the transition plan has not yet been developed.

27.59 The authority for the new Program stated that all grants and contributions to organizations other than those that receive sustaining funding would follow the new terms and conditions effective 1 April 1997. However, while draft material was available in advance, documentation for assessing applications under the new Program was not distributed to all staff until June 1998. Our file review indicated that even though the new Program has been introduced, the influence of the old Program is still evident. In practice, the officers often assess the projects in the same way as before. We also noted that many approved projects tend to reflect goals of the old program rather than the new one.

Monitoring of performance could be improved

27.60 Given the large number of projects and the small individual amounts of money involved, Canadian Heritage has opted to use grants more often than contributions. Nevertheless, the Department often asks grant recipients to provide financial or performance information about their project in order to receive instalment or final payments. These requirements create an incentive for the recipients to describe how the funds have been used and what results have been achieved. However, we noted some cases where payments were made to recipients who had not met these conditions.

27.61 Within two months of the project's completion, a descriptive report of the project is supposed to be forwarded to the Department. However, in a third of the files we audited, we found that these reports had not been provided.

27.62 Since the Program often funds projects of the same organizations year after year, these reports are an important way for program officers to maintain a good knowledge of an organization's performance.

27.63 The Department of Canadian Heritage should:

- **further clarify the objectives of the Multiculturalism Program by defining clear, attainable goals and expected annual results;**
- **ensure that due diligence is exercised in the review and approval of grants and contributions under the Program; and**
- **ensure that recipients provide the required performance information.**

Department's response: The audit reviews the first year of a renewed Multiculturalism Program. As we implement the new directions, we find that the transition is taking more time than anticipated. Voluntary organizations and community groups traditionally funded by the Department to address complex social issues are facing significant challenges in adjusting their resourcing, operations and priorities to the evolving direction of the Program.

The Department acknowledges the importance of further clarifying program objectives. In this regard, the Department provides: assistance and direction to all program staff in their interpretation of program objectives, approved goals and priorities for 1998-2001; comprehensive reference materials; and training workshops. In the interest of due diligence, renewed emphasis will be placed on the rigorous application of assessment criteria in the review and approval of grants and contributions, concentrating on areas for improvement identified in the audit.

Finally, in keeping with your recommendation that recipients provide the required performance information, we will monitor the results of approved grants and contributions in order to analyze and assess their impacts and effectiveness.

INDIRECT DELIVERY OF CONTRIBUTION PROGRAMS: INDUSTRY CANADA

Accountability for Indirect Program Delivery

27.64 Increasingly, departments provide funding to organizations outside the federal government that, in turn, decide on the ultimate recipients of the money and manage the funding agreements. This kind of arrangement is

referred to as indirect program delivery. Such an arrangement complicates the relationship between the department and program beneficiaries, and demands renewed attention to the principles of accountability to Parliament for the spending of public money.

27.65 We indicated in our recent work on modernizing accountability practices in the public sector that whether a department delivers a program directly or uses an arrangement with an external organization to meet its objectives, the need for accountability does not change.

27.66 Indirect delivery arrangements require special accountability measures, since departmental managers can no longer rely on continuing supervision and adjustment to achieve expected results. In the terms of our performance management framework for grant and contribution programs, management must still satisfy itself that all the qualities are met even though it is not directly managing operations. Consequently, great care is needed in defining objectives and performance criteria in advance. Once a funding agreement is in place, ongoing assessment is required to ensure that performance is in line with expectations and that the external organization exercises due diligence in selecting and managing projects.

Contributions to CANARIE Inc. and PRECARN Associates Inc.

27.67 Our audit scope in examining indirect program delivery was Industry Canada's responsibilities under the contribution agreements with CANARIE Inc. (CANARIE) and PRECARN Associates Inc. (PRECARN). We did not audit the operations of CANARIE or PRECARN, and none of our observations should be interpreted as comments on the performance of either organization.

What is CANARIE?

27.68 The Canadian Network for the Advancement of Research, Industry and Education (CANARIE) is a not-for-profit industry-led consortium created in 1993 with support from the federal government. Its purpose is to accelerate the development of the Information Highway in Canada, and to facilitate development of critical aspects of the communications infrastructure in order to contribute to Canadian technology industry competitiveness in the global economy, to wealth and to job creation.

27.69 CANARIE is governed by a volunteer board of directors and is composed of over 120 fee-paying members from businesses, universities, research institutions and government organizations. CANARIE supports the following type of activities:

- operation and upgrading of CA*net, the backbone of Canada's research Internet;
- the creation of a very high-speed network to allow Canadian companies and researchers to test advanced networking technology;
- programs to support technology development and diffusion, and product and service development; and
- an outreach program to increase awareness and communicate the benefits of an information-based economy in Canada.

27.70 CANARIE activities are proceeding in three phases. Phase 1 (1993-95) cost approximately \$125 million, of which the federal government contributed \$27 million through Industry Canada; Phase 2 (1995-99) will cost more than \$400 million, of which Industry Canada is contributing \$80 million; and Phase 3 is in the planning stage at this

time. In 1998, CANARIE was also awarded a one-time grant of \$55 million to help develop a national optical network, which was not covered in this audit.

27.71 CANARIE is not required to repay the federal government's contributions. CANARIE has been authorized to implement cost recovery agreements with contractors receiving CANARIE support for technology applications development projects and subsequently to retain repayments for use in reducing the amount of the federal contribution for the planned Phase 3 CANARIE activities.

Accountability for program performance could be improved

27.72 We examined the Phase 2 contribution agreement between Industry Canada and CANARIE. The agreement requires CANARIE to submit a business plan and an operating plan. In examining these documents, we found that although they provide performance goals for Phase 2, they do not include annual performance expectations against which the Department could monitor performance of CANARIE activities. We also noted that there was no requirement for annual updates to these plans or for annual performance reports by CANARIE.

27.73 Consequently, we found that Industry Canada does not monitor results achieved annually by CANARIE in a structured way. Although departmental files contain quarterly progress reports for sub-projects, there are no performance reports for core activity areas or for CANARIE activities as a whole. Industry Canada managers advised us that they have some oversight mechanisms in place that keep them aware of program performance. Industry Canada has observer status on the CANARIE Board of Directors and other committees and regularly attends these and other meetings. In our opinion, these mechanisms are a useful supplement to regular reporting on performance but should not replace it.

27.74 The agreement with CANARIE makes provision for program evaluations at the end of each phase. Program evaluation is a useful and necessary performance measurement tool but, in our view, it is not a substitute for annual monitoring of performance.

27.75 The results of the recent evaluation support our observation that more frequent performance monitoring by Industry Canada would be in order. The evaluation concludes that CANARIE has met the objectives set for Phase 2. But it also points to a number of concerns that may limit the overall effectiveness of CANARIE's work. The establishment and regular monitoring of performance goals could help Industry Canada and CANARIE to address such problems as they emerge.

Stronger assurance is needed that CANARIE practices meet expectations

27.76 We found that Industry Canada was not doing enough to assure itself that the practices followed by CANARIE in selecting and managing projects meet departmental requirements. At our request, Industry Canada obtained additional information from CANARIE describing the review, approval and selection practices for sub-projects and their management. In our opinion, Industry Canada needs to review this information in light of their expectations and obtain assurance that the procedures are being followed.

27.77 Although the agreement with CANARIE provides for access by the Department to CANARIE documents and premises, officials advised us that to date they have not seen the need to exercise this right. The Department may want to consider the merits of including a clear provision for program performance audit in any future agreement with CANARIE as this can be an important tool to assure Industry Canada that due diligence is exercised by CANARIE.

Industry Canada has satisfactory assurance that the funds are being used for the purposes agreed

27.78 We examined a sample of Industry Canada project files on CANARIE to determine if, once projects had been approved, the Department had adequate assurance that funds were being spent for the purpose agreed and if there were adequate financial controls in place.

27.79 We found that Industry Canada receives financial claims from CANARIE on a quarterly basis, with proper documentation. In addition, Industry Canada receives a copy of all agreements entered into by CANARIE, and final project reports that describe, among other things, whether the technical goals of the project were met but do not describe the results that were achieved. Departmental officials review these reports.

What is PRECARN?

27.80 PRECARN was established in 1987 as a not-for-profit, industry-led corporation. Managed by a volunteer Board of Directors, PRECARN is a national consortium of Canadian corporations to encourage and support long-term pre-competitive research in advanced robotics and artificial intelligence. Since 1995, PRECARN's scope has broadened to support market-oriented research and development and to promote the understanding, use and exploitation by Canadian industry of intelligent systems and advanced robotics.

27.81 PRECARN is funded under the Strategic Technologies Program (STP) of Industry Canada. The objective of the Program is to enhance the international competitiveness of Canadian industry through the development, acquisition, application and diffusion of strategic technologies in Canada. Support to PRECARN differs from the other types of research and development alliances funded under the STP. PRECARN itself does not perform research, but manages a series of industry-led projects carried out by networks of research teams across the country.

27.82 PRECARN has been supported through non-repayable contributions under the STP since 1989. Under Phase 1, the Treasury Board approved the provision of financial assistance to PRECARN of up to \$16 million over a six-year period. Phase 2 was approved in late 1994. It comprised an additional \$19.9 million (revised to \$19.4 million) over the five-year period from 1995-96 to 1999-2000.

27.83 The Phase 2 research program involves a total investment by all partners in excess of \$50 million over the period 1995-2000. Industry Canada's contribution of \$19.4 million represents approximately 40 percent of the total funding, with the balance coming from industry, PRECARN itself, the provincial government and other federal institutions. Our audit focussed on Phase 2.

Accountability for performance could be improved

27.84 We reviewed the terms and conditions of the contribution agreement between Industry Canada and PRECARN. We found them to be consistent with the objectives and funding criteria of the Strategic Technologies Program. These terms and conditions included provisions for oversight and reporting.

27.85 However, we found that although the agreement provided for oversight by Industry Canada, in practice some of the provisions were not being followed.

27.86 As required by the agreement, PRECARN submits an annual business plan, setting out clear performance expectations. In its capacity as an official observer to the PRECARN Board of Directors, Industry Canada is in a position to comment on the development of the plan. However, we saw no evidence that Industry Canada undertakes an independent review of the plan to ensure that it is in line with departmental expectations; nor does Industry Canada formally approve the plan, as the agreement requires.

27.87 We also found that the Department does not monitor, in an independent way, the results achieved annually. Industry Canada officials informed us that they have some mechanisms in place to monitor performance. These include participating in meetings of the PRECARN Board of Directors and other committees in an observer capacity, attending PRECARN conferences and workshops and other meetings, as well as periodic program evaluations at roughly five-year intervals. We acknowledge the value of these mechanisms but maintain that annual independent performance monitoring, as required by the agreement, is essential for effective accountability.

Industry Canada could improve its assurance that funds are being used for the purposes agreed

27.88 The agreement between Industry Canada and PRECARN stipulates that claims for payment should be accompanied by brief quarterly progress reports on each approved project and that claims should be certified by an officer of PRECARN. Our review of Industry Canada files revealed that quarterly reports did not accompany claims for payments in more than two thirds of the cases, although claims were duly certified by a PRECARN officer. We question whether Industry Canada is able to assure itself fully prior to payment of a claim that funds are being used for the purposes agreed. Information on the work completed would be in quarterly reports, which do not routinely accompany the claims. Officials stated that, in their view, certification of the claims by an officer of PRECARN provides adequate assurance that funds are being used for the purposes agreed. However, we maintain that such certification does not remove from Industry Canada the obligation to implement the terms of the agreement.

Greater assurance is needed that PRECARN practices meet expectations

27.89 In grant and contribution programs, due diligence requires that applications for funding be assessed against terms and conditions established by the Treasury Board. With indirect program delivery, such as in the case of PRECARN, we would expect Industry Canada to obtain assurance that the processes used to select projects for funding respect those terms and conditions. We acknowledge that Industry Canada's participation in PRECARN management committee and Board meetings as an observer does offer some assurance that PRECARN's decision-making processes represent due diligence. However, assurance would be strengthened by Industry Canada fulfilling its obligations to review and approve the annual business plan, which contains a description of the processes used by PRECARN to ensure due diligence.

27.90 In addition, the agreement with PRECARN stipulates the Minister's right to access PRECARN documents and premises to assess the progress and results of the work. Officials advised us that to date they have not seen a need to exercise this right. In our view, periodic program performance audit is another important tool to assure Industry Canada that due diligence is exercised by PRECARN.

27.91 Industry Canada should:

- **obtain assurance that CANARIE and PRECARN exercise due diligence in selecting and managing projects;**
- **set clear annual performance expectations for its contributions; and**
- **assess performance annually.**

Department's response: CANARIE and PRECARN are innovative approaches created to efficiently and effectively forge private-public sector research and development linkages. In the development of innovative program management techniques, Industry Canada has relied upon a number of mechanisms (i.e. Board participation, meetings with CANARIE/PRECARN management), and various performance indicators to ensure that due diligence was achieving their intended objectives. As "third-party delivery" management practices continue to be refined in government, more sophisticated performance measurement frameworks, focussing on the core components of

performance measurement (i.e. reach, results, resources), have been developed. In this context, the Auditor General's review has been useful and timely given the Department's policy agenda. The Auditor General's comments will be fully considered as performance measurement techniques are implemented in the future management of these and similar programs.

Conclusion

27.92 The purpose of our audit was to determine whether there were opportunities to improve the management of specific programs in Industry Canada and Canadian Heritage. The grant and contribution programs that we audited dealt with economic and social development issues — Ontario Base Closures Assistance Program and the Multiculturalism Program respectively. These programs are good examples of programs delivered by departments directly. We also audited examples of indirect delivery — Industry Canada's contribution agreements with CANARIE and PRECARN — since this approach is becoming increasingly common.

27.93 We concluded that there are significant opportunities to improve the management of these programs and individual contribution agreements.

- Industry Canada needs to apply the terms and conditions approved by the Treasury Board for the Department's grants and contributions. Good documentation is a necessary part of proper justification for the decision to fund projects.
- Canadian Heritage needs to clarify the objectives of the Multiculturalism Program by defining clear, attainable goals and expected annual results. It also needs to ensure due diligence is exercised in the approval of grants and contributions under the Program.
- In indirect delivery arrangements, it is important that Industry Canada have assurance that the organizations with which it has contribution agreements exercise due diligence. The Department also needs to set clear annual performance expectations for these arrangements and assess performance annually.

About the Audit

Objective

Our audit objective was to determine whether there are significant opportunities to improve the management of specific programs in Industry Canada and the Department of Canadian Heritage. We do not provide an opinion on all aspects of the management of these programs.

Criteria

We examined whether management assured itself that:

- the projects represented value for money to both the applicant and the program; and
- the funds were used for the purposes agreed.

While we focussed on these two criteria in particular, we also considered other qualities from our performance management framework for grant and contribution programs where appropriate.

Scope

We examined grant and contribution programs delivered directly by Industry Canada and Canadian Heritage. We also examined indirect delivery arrangements in Industry Canada. Direct delivery refers to grants and contributions managed entirely by a department. Indirect delivery refers to arrangements where a department contributes funds to an organization outside the government that, in turn, distributes funding to the intended recipients.

Direct Delivery

- Industry Canada: Contributions under Ontario Base Closure Adjustment Program
- Canadian Heritage: Grants and Contributions under the Multiculturalism Program

Indirect Delivery

- Industry Canada: Contributions to Canadian Network for the Advancement of Research, Industry and Education (CANARIE), and to Precompetitive Advanced Research Network (PRECARN)

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Appendix A

Planned Expenditures on Grants by Departments and Agencies, 1998-99*

Department/Agency	\$ Millions	Statutory (percentage)	Purpose
Human Resources Development	23,155.40	99.2%	Old age security, guaranteed income supplements, scholarships, labour benefits and income support, promoting integration of disabled persons, fishers and plant workers affected by the East Coast groundfish crisis
Veterans Affairs	1,229.00	0.02%	Compensation for death and disability, War Veterans Allowances
Indian Affairs and Northern Development	882.20	14.3%	Implementation of land claim settlements; administration of bands, councils, educational and cultural activities; research in the North; Healing Strategy
Natural Sciences and Engineering Research Council	475.80	-	Scholarships and grants in aid of university research
Canadian International Development Agency	351.20	-	Development assistance, programs against hunger and malnutrition, humanitarian assistance, disaster preparedness
Medical Research Council	257.70	-	Scholarships and grants in aid of university research
Finance	150.20	-	Commitments under multilateral debt reduction agreements, equalization payments to provinces
Citizenship and Immigration	148.90	-	Integration of newcomers to Canada
Social Sciences and Humanities Research Council	92.50	-	Scholarships and grants in aid of university research
Agriculture and Agri-Food (portfolio)	74.80	0.3%	Economic development and innovation
Department of Canadian Heritage (portfolio)	72.10	0.9%	Cultural development, Canadian identity
Justice (portfolio)	62.30	75.3%	Annuities under the <i>Judges Act</i> , Safer Communities Initiative
Health	58.60	-	Support for programs and project on health, community health promotion, training and skill development, Canadian Blood Services, Canadian Strategy on HIV/AIDS, Canadian Breast Cancer Research Initiative
National Revenue	44.00	100.0%	Children's special allowance payments
Solicitor General	42.30	93.0%	Pensions and benefits to RCMP members; advice to Solicitor General
Foreign Affairs and International Trade	23.70	1.1%	Public diplomacy, public and cultural relations, marketing abroad
Transport	22.50	-	Policy development initiatives
Privy Council (portfolio)	16.00	-	Preparation and distribution of documents and reports by the Institute of Intergovernmental Affairs, Queen's University for the Cabinet and Cabinet committees; Millennium Bureau of Canada
National Research Council of Canada	5.20	-	Support for research and industrial innovation
Atlantic Canada Opportunities Agency	5.00	-	Economic co-operation and development in Atlantic Canada
Western Economic Diversification	5.00	-	Facilitating access to capital and business information, developing and delivering targeted business services in Western Canada
National Defence	4.00	4.4%	Activities to assist in achieving defence objectives, corporate management and support services
Environment	3.30	-	Universities, research and related activities
Canadian Space Agency	1.10	-	University research, scholarships and fellowships
Industry Canada	0.70	-	Canada Scholarships Program

Natural Resources	0.50	-	Research and development, activities contributing to departmental objectives
Economic Development Agency of Canada for the Regions of Quebec	0.40	-	Support for innovation, market development, entrepreneurship in Quebec
Treasury Board	0.30	24.7%	<i>Public Service Pension Adjustment Act</i> , Workers' Compensation
Fisheries and Oceans	0.20	-	Research and development activities
Others	0.50	97.6%	
Total	27,185.40		

*For more details, refer to Performance Reports of each department and agency.

Source: 1998-99 Estimates, Part II - The Main Estimates and Supplementary Estimates (A).

Appendix B

Planned Expenditures on Contributions by Departments and Agencies, 1998-99*

Department/Agency	\$ Millions	Statutory (percentage)	Purpose
Indian Affairs and Northern Development	3,474.30	-	Economic development, education and social development, health care, research and training, employment initiatives
Human Resources Development	1,686.40	47.8%	Student loans, training and/or work experience, child care initiatives, retraining, development of learning and training technologies, adults with disabilities
Canadian International Development Agency	989.80	-	Development assistance, payments for loan agreements
Agriculture and Agri-Food Canada (portfolio)	967.60	72.3%	Economic development, market access and development, innovation, ice storm assistance
Health	730.20	-	Aboriginal health services, facilities, education; health research, alcohol and drug treatment, tobacco control enforcement, health information systems, Canadian Blood Agency, Canadian Strategy HIV/AIDS
Industry Canada	547.50	13.7%	Industry sector development including technological innovation, research and development, job creation
Transport	544.00	40.3%	Subsidy programs for divestiture of and operation of ports, airports, highways and bridges; transition payments to NAV CANADA; research and development, monitoring, testing, inspection, safety and security programs
Department of Canadian Heritage (portfolio)	466.20	-	Promoting official languages, broadcasting distribution, Canadian identity, developing athletes, national parks
Economic Development Agency of Canada for the Regions of Quebec	371.80	24.9%	Innovation, market development, entrepreneurship, economic recovery in Quebec
National Defence	367.70	4.9%	Support to NATO; pension and retirement benefits; support to the UN training assistance programs and peacekeeping operations; civil emergency preparedness, natural disasters
Justice (portfolio)	288.00	-	Legal aid systems, cost-sharing of juvenile justice services, firearms program, supporting funds related to Justice, Safer Communities Initiative
Western Economic Diversification	270.50	16.3%	Business development, research and development, specialized loans and investment funds, infrastructure works in Western Canada
Foreign Affairs and International Trade	264.90	-	International security and co-operation, international business development, export market development
Atlantic Canada Opportunities Agency	264.30	3.9%	Regional development programs and activities
Finance	171.40	-	Commitments under multilateral debt reduction agreements in Atlantic Canada
Citizenship and Immigration	166.20	-	Integration of newcomers, humanitarian aid
Veterans Affairs	158.10	-	Extended health care costs not covered by provincial health programs
National Research Council of Canada	143.80	-	Support for research, technology and innovation; developing, adapting and exploiting technology
National Revenue	92.80	-	Joint administration costs of federal and provincial sales tax
Natural Resources	75.70	17.0%	Research and development; supporting management and sustainable development; ensuring federal policies, Climate Change Action Fund and regulations enhance the contribution of natural resources to Canada's economy while protecting the environment
Solicitor General	52.20	-	Policing for First Nations and Inuit communities
Treasury Board	44.20	-	Youth Internship Program

Fisheries and Oceans	41.60	0.5%	Increasing Native participation in commercial fisheries, benefits relating to moratorium on northern cod fishery
Environment	36.90	-	Understanding the environment and our environmental responsibilities and taking action to protect, conserve and adapt Climate Change Action Fund
Privy Council (portfolio)	26.10	-	Millennium Bureau of Canada
Canadian Space Agency	21.90	-	Ensuring Canadian leadership in emerging international Earth observation markets, and competitiveness through technology transfer and diffusion
Others	0.90	-	
Total	12,265.00		

*For more details, refer to Performance Reports of each department and agency.

Source: 1998-99 Estimates, Part II - The Main Estimates and Supplementary Estimates (A).

Chapter 28

Follow-up of Recommendations in Previous Reports

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Follow-up of Recommendations in Previous Reports

Main Points

28.1 The amount of progress toward meeting the recommendations of previous audits covers a broad spectrum. In some cases, all significant recommendations have been addressed. In other cases, there is little or no evidence of corrective action being taken. Most cases fall somewhere between these extremes.

28.2 The following significant areas of concern remain:

- Health Canada is not in a position to effectively co-ordinate and respond to a major nuclear accident affecting Canada.
- It is not clear whether the Code of Environmental Stewardship is still in place for those agencies not required to produce a sustainable development strategy and there is also a need to involve Crown corporations in the government's greening efforts.
- We observed that adequate strategic reconnaissance is still not being conducted prior to deployment of all peacekeeping missions.
- Awareness of the potential risks to health, safety and the environment from federal contaminated sites, and the government's lack of a comprehensive plan to manage its risks and associated costs is still an issue.
- Information systems under development remain a concern due to their significance, in terms of the size of the investments and their impact on operations, and continuing delays in the planned implementation dates for certain systems.

28.3 There are also successes to report:

- Since our audit in 1996, materiel management has decreased reported inventories in four departments by more than \$480 million.
- Progress has been made in improving the quality of internal audit management.
- Revenue Canada has taken steps to ensure that excise taxes and duties on selected commodities are correctly assessed, collected and reported.
- Progress has been made in strengthening the control and accountability of the Canadian intelligence community.

28.4 We are encouraged by the amount of progress reported, and urge departments and agencies to continue their efforts in addressing our concerns until all significant matters have been resolved through corrective action.

Introduction

28.5 At a suitable time after each of our audits, we review the actions taken by departments in response to observations and recommendations made in our reports and by parliamentary committees.

28.6 The purpose of our follow-up work is to provide Parliament with a progress report on action taken by departments in response to our previous recommendations. We continue to monitor these issues until corrective action is implemented or until recent events make further action unnecessary.

28.7 Our follow-up work provides a moderate level of assurance that departments have acted on our recommendations. In most cases, it is performed through a review of documentation, interviews with departmental officials, and a review of any other evidence that allows us to draw a conclusion on the plausibility of the information presented.

28.8 We normally report on the status of progress made two years after we publish the original chapter, but this may vary depending on the scope or complexity of changes undertaken by departments. Some follow-up activity is reported as separate chapters, or reported with audits of similar issues. Exhibit 28.1 provides a list of audits due for follow-up but not included in this chapter.

Exhibit 28.1

Other Chapters Due for Follow-up

Year and Chapter	Chapter Title	Original Responsible Auditor	Follow-up Status
1993			
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 2000.
1994			
9	Science and Technology - Overall Management of Science and Technology Activities	Richard Flageole	<p>These audits are being followed up in a phased approach:</p> <ul style="list-style-type: none"> • Government-wide issues related to the management of research activities and scientific personnel were followed up in Chapter 15 of our 1996 Report. Further progress is found in Chapter 22 of this report. • Issues at the departmental level will be the subject of further study, tentatively planned to report in 1999, and an audit planned to report in 2000. • Our follow-up work dealing with the "Framework for the Human Resource Management of the Federal Scientific and Technical Community" is planned to report in 1999.
10	Science and Technology - Management of Departmental Science and Technology Activities	Richard Flageole	
11	Science and Technology - The Management of Scientific Personnel in Federal Research Establishments	Jacques Goyer	
12	Aspects of Federal Real Property	Reno Cyr	Deferred. Government downsizing has resulted in departments being

	Management		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 1994 Chapter 34 below.
18	Correctional Service Canada - Supervision of Released Offenders	David Brittain	Deferred. Planned to be combined with a follow-up of Chapters 10 and 30 of the 1996 Report, and included in a separate chapter planned to report in 1999.
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 1994 Chapter 12 above. Tentatively planned to be combined with an audit of this area planned to report in 1999.
1995			
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 the 1997 Report planned to report in 2000.
9	Information for Parliament - Deficits and Debt: Understanding the Choices	Jeff Greenberg	Reported in Chapter 6 of the April 1998 Report.
10	Crown Corporations - Fulfilling Responsibilities for Governance	Grant Wilson	Portions of the chapter are being followed up in a phased approach: S Performance measurement was followed up in Chapter 22 of the December 1997 Report. S Further follow-up on special examinations is planned to report in 2000.
13	Canadian International Development Agency - Phased Follow-up: Geographic Programs - Phase I	Vinod Sahgal	This chapter was the first segment of a phased follow-up to Chapter 12 of the 1993 Report. Phase II was reported in Chapter 29 of the 1996 Report. The final phase is reported in Chapter 21 of this report.
24	Revolving Funds in the Parliamentary System - Financial Management, Accountability and Audit	Michael Weir	Deferred. Tentatively planned to report in 1999.
1996			
3	Evaluation in the Federal Government	Stan Divorski	Deferred. Tentatively planned to be combined with an audit of performance reporting to Parliament planned to report in 2000.
5	Reform of Classification and Job Evaluation in the Public Service	Jacques Goyer	Deferred. Tentatively planned to report in 2000.
8	CSIS - National Headquarters Building Project	Reno Cyr	Deferred. Tentatively planned to report in 1999.
10	Correctional Service Canada - Rehabilitation Programs for Offenders	David Brittain	Deferred. Planned to be combined with a follow-up of Chapter 18 of the 1994 Report and Chapter 30 of the 1996 Report, and included in a separate chapter planned to report in 1999.
13	Study of Accountability Practices from the Perspective of First Nations	Ronnie Campbell	There will be no follow-up of Chapter 13. It was a study and contained no recommendations.
14	Service Quality	Theresa Duk	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 1999.
15	Federal Science and Technology Activities - Follow-up	Richard Flageole and Jacques Goyer	There will be no separate follow-up of Chapter 15. It was a follow-up of the government-wide issues raised in Chapters 9 and 11 of the 1994 Report. Further progress is found in Chapter 22 of this report.
16	Treasury Board Secretariat - Renewing Government Services Using Information Technology	Nancy Cheng	Deferred. Tentatively planned to report in 1999.
17	Human Resources Development Canada - Canada Pension Plan: Disability	Louis Lalonde	Deferred. Tentatively planned to report in 1999.
19	Revenue Canada - Child Tax Benefit and Goods and Service Tax Credit Programs	Basia Ruta	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 2001.

21	Federal Debt Management	Brian Pearce	There will be no follow-up of Chapter 21. It was a study providing information to Parliament on management of debt and contained no recommendations. This will be subject of an audit planned to report in 1999.
25	Canada's Export Promotion Activities - Foreign Affairs and International Trade and Industry Canada.	Lew Auerbach	Deferred. Tentatively planned to report in 1999.
26	Canada Infrastructure Works Program: Lessons Learned	Henno Moenting	Deferred. Tentatively planned to be combined with an audit in this area planned to report in 1999.
29	Canadian International Development Agency: Phased follow-up: Geographic Programs - Phase II	Vinod Sahgal	This chapter was the second segment of a phased follow-up to Chapter 12 of the 1993 Report. Phase I was reported in Chapter 13 of the 1995 Report. The final phase is reported in Chapter 21 of this report.
30	Correctional Service Canada - Reintegration of Offenders	David Brittain	Deferred. Planned to be combined with a follow-up of Chapter 18 of the 1994 Report and Chapter 10 of the 1996 Report, and included in a separate chapter planned to report in 1999.
33	Indian and Northern Affairs Canada - Funding Arrangements for First Nations	Grant Wilson	Deferred. Tentatively planned to report in 1999.
34	National Defence - Support Productivity	Peter Kasurak	Deferred. The original chapter looked at the Department of National Defence mid-way through its renewal process. The follow-up will be conducted after the renewal process is complete and is tentatively planned to report in 2000.

28.9 Summarizing all follow-up work reported in 1998, approximately 49 percent of our previous recommendations have been fully implemented or are proceeding at a satisfactory rate. About 44 percent of our previous recommendations require additional effort before corrective action can be considered complete. The remainder are cases where the department did not agree with our recommendations, or subsequent events have rendered the recommendation no longer applicable.

28.10 This chapter reports on the follow-up of 21 audits conducted between 1992 and 1996. The results are extremely varied. They range from all recommendations having been suitably addressed to cases where action on all recommendations has been insufficient. Results in the majority of the individual reports lie somewhere between these two extremes.

Emergency Preparedness in the Federal Government — Nuclear Emergencies — 1992, Chapter 24

Assistant Auditor General: David Rattray
Principal: Alan Gilmore

Background

28.11 We reported to Parliament on federal government emergency preparedness in 1987, 1989 and 1992 for catastrophic earthquakes, chemical and oil spills and nuclear accidents. In 1995 and 1997, we reported that major improvements were still needed in preparing for major earthquakes and chemical and oil spills.

28.12 This report focusses on emergency preparedness for major nuclear accidents. Our 1987 and 1992 reports noted that major improvements were needed in federal preparedness and response planning for nuclear emergencies.

28.13 Municipal, provincial and federal governments share responsibility for emergency planning. Primary responsibility rests with the provinces. If the nuclear emergency is beyond the municipal and provincial capacity, provinces can request federal involvement. However, the co-operation of all levels of government is required to ensure that emergency plans, policies and procedures will work when needed.

28.14 In 1984, Health Canada was designated the lead federal government department for planning and responding to nuclear emergencies. This designation was reconfirmed in 1994. The first version of the Federal Nuclear Emergency Response Plan was issued in 1984, and revised in 1991. In October 1993, Health Canada initiated a comprehensive review of the Plan, which was completed in March 1994. Subsequently, the Department initiated a multi-year project to revise the Plan, and in December 1997 an interim Plan was issued.

28.15 The Plan addresses nuclear emergencies resulting from serious accidents involving nuclear power generating stations, nuclear-powered vessels and nuclear weapons, and the re-entry of nuclear-powered satellites. Threats also can arise from serious accidents in other countries.

28.16 The Atomic Energy Control Board (AECB), Canada's nuclear regulatory agency, is responsible under the *Atomic Energy Control Act* for inspecting and regulating nuclear materials throughout their life cycle. Its responsibilities include regulating the nuclear reactors, the use of radioactive materials in industry and institutions, and the transportation and disposal of nuclear radioactive wastes.

Scope

28.17 We reviewed the progress made since 1992 in addressing the recommended improvements in federal government preparedness for nuclear emergencies.

Conclusion

28.18 While some progress has been made, most of the concerns about federal government preparedness for nuclear emergencies reported in our 1992 chapter have not yet been adequately addressed. We are concerned that Health Canada is not in a position to effectively co-ordinate and respond to a major nuclear accident affecting Canada.

28.19 Although Health Canada has issued an interim response plan called the Federal Nuclear Emergency Plan, other federal departments and agencies and the provinces have not yet approved it. Neither the new Plan nor its predecessor has been tested in an integrated interdepartmental, provincial and municipal exercise. CANATEX 3, a “desk top” simulation exercise of the Plan, was scheduled for April 1998 but has been postponed to April 1999.

28.20 Three provinces have established radiation exposure standards for initiating protective action as a result of a nuclear emergency; however, the standards differ among the provinces. We believe that national standards are needed to avoid delays and confusion in responding to radiation exposure.

28.21 A July 1997 report by Ontario Hydro concluded that all its nuclear power generating stations were performing substantially below industry standards, but producing minimally acceptable results. Over the past decade, the Atomic Energy Control Board has regularly advised Ontario Hydro that it needed to take substantial corrective action.

28.22 The AECB has concluded that Ontario Hydro nuclear reactors can continue to operate safely in the short term. However, the Board cautioned that “defence-in-depth” for safety has been eroded at Ontario Hydro nuclear generating stations. AECB also advised us that the nuclear stations in Quebec and particularly New Brunswick were experiencing problems similar to those in Ontario, but that these are more easily remedied.

Observations

After six years the Federal Nuclear Emergency Plan is still incomplete

28.23 Since our 1992 audit, Health Canada has conducted a review of the Federal Nuclear Emergency Response Plan. In December 1997, it issued an interim plan, now renamed the Federal Nuclear Emergency Plan.

28.24 Detailed planning has yet to be completed. Those matters that still need to be addressed include preparing an implementation plan, identifying interfaces with all provinces, developing communication protocols for departments and provinces, and establishing technical co-ordination plans for plume tracking, field surveys, dose assessment and food control. Training requirements and any formal arrangements that may be needed among federal departments and agencies also need to be addressed.

28.25 Thirteen federal departments and agencies that have major responsibilities for responding to nuclear accidents have been consulted, but they have not yet indicated their approval of the Plan. Health Canada has received departmental support plans from only two of these departments, and it has not completed its own departmental support plan. Without departmental plans, it is difficult to establish standard operating procedures that identify the required tasks, when these tasks should be performed, and the staff who should perform them.

28.26 Emergency Preparedness Canada established the Emergency Preparedness Advisory Committee. It is composed of assistant deputy ministers of departments and agencies that would have significant roles and responsibilities in responding to emergencies of all types, including nuclear emergencies. The interim Federal Nuclear Emergency Plan identifies an Executive Group composed of members of the Advisory Committee. The Group’s responsibilities include decision making, implementation of the Plan, briefings to Cabinet and conflict resolution.

28.27 We are concerned that decision making and implementation of the Plan may be hampered because most of the assistant deputy ministers on the Advisory Committee have not attended meetings of the Committee during the last four years, and none have participated in emergency preparedness training sessions specifically designed to prepare them for their roles.

The interim Federal Nuclear Emergency Plan still needs to be tested

28.28 The Federal Nuclear Emergency Plan has not been tested in integrated interdepartmental, provincial and municipal exercises. The Plan was to be tested during a “desk-top” exercise called CANATEX 3 in April 1998. However, Emergency Preparedness Canada told us that the exercise was postponed to April 1999 at the request of the Province of Ontario. Such a test is needed to determine the weaknesses in the emergency response capabilities and to allow for corrective actions to be taken.

There are no national radiation exposure standards for initiating protective measures

28.29 Our 1992 Report pointed out that the Federal Nuclear Emergency Response Plan did not provide guidance on the specific levels of radiation at which action should be initiated to protect against radiation exposure from contaminated air, water, soil and food as a result of a nuclear emergency.

28.30 The interim Plan includes the provincial guidelines on specific levels of radiation at which action should be initiated to protect against radiation exposure. The three provinces with nuclear power plants — Ontario, Quebec and New Brunswick — have adopted different levels of radiation exposure as the threshold for initiating protective measures. Such measures include advising people to stay indoors, evacuation, distributing stable iodine, and temporary and permanent relocation. Other jurisdictions have not established standards.

28.31 The lack of common standards may result in unnecessary delays, concerns and confusion because citizens of different provinces confronted with similar threats may receive different advice and direction. We note that the United States and the United Kingdom have adopted national radiation exposure standards for initiating protective action. We believe national standards of radiation exposure for initiating protective action are required.

28.32 Health Canada told us that it is presently working on a national safety standard for food and water that are contaminated as a result of a nuclear emergency, and that it intends to develop a national standard for radiation exposure for the public.

The interim Plan recognizes that the provinces have primary responsibility and will seek federal assistance as needed

28.33 The interim Plan recognizes that the provinces have primary responsibility for health and safety and for addressing nuclear emergencies that affect their populations as a result of accidents in Canada, the United States and elsewhere. The interim Plan contains five interim provincial annexes prepared by Health Canada and the emergency measures organizations of Ontario, Quebec, New Brunswick, Nova Scotia and British Columbia. The interim provincial annexes briefly describe on a summary level the concept of operations, links between federal and provincial organizations, and the roles of federal and provincial governments. Annexes for the remaining provinces and territories have not been developed.

28.34 Health Canada acknowledges that there are significant differences among the provinces in resources, capabilities and needs. In our 1992 Report, we recommended that the Federal Nuclear Emergency Response Plan should, to the extent possible, indicate the support and resources that provinces would need and where such resources might be obtained. Health Canada still has no information on the needs or the support resources required by the provinces.

Major improvements in nuclear power station operations are needed

28.35 In July 1997, Ontario Hydro reported the findings of its Independent Integrated Performance Assessment and Safety System Functional Inspections of its nuclear power generating stations. The report assessed all stations in

terms of nuclear safety, production, environmental matters and cost competitiveness. It ranked all stations as “minimally acceptable”— that is, “performance is substantially below industry standards but produces minimally acceptable results.”

28.36 Emergency preparedness includes such matters as processes to control fires, to respond to radiological emergencies, and to maintain emergency preparedness plans. Ontario Hydro’s report ranked all stations as “below standard” with respect to emergency preparedness — that is, “performance is below industry standards and generally produces the desired results.”

28.37 Since 1989, the AECB has regularly advised Ontario Hydro that substantial corrective actions were needed in the operation of its nuclear power generating stations. The AECB’s follow-up report on the July 1997 Ontario Hydro report concluded that although “defence-in-depth” for safety has been eroded at Ontario Hydro nuclear generating stations, the reactors could continue to operate safely in the short term.

28.38 The AECB report also noted that significant improvement is necessary in Ontario Hydro’s operations to improve safety margins and to prevent further deterioration in performance. The AECB advised us that the status of nuclear stations in Quebec and particularly New Brunswick is similar to that of Ontario Hydro; however, the problems at the Quebec and New Brunswick stations are more easily addressed because these are smaller nuclear facilities.

Health Canada — Management of the Change Initiative at Health Protection Branch — 1995, Chapter 4

Assistant Auditor General: Maria Barrados

Director: Ronnie Campbell

Background

28.39 The Health Protection Branch of Health Canada is mandated to carry out programs to assess and manage the public health risks faced by Canadians. In 1995 we reported on progress made by the Branch on a program re-engineering initiative it undertook starting in 1993. The Branch began its self-initiated change process to resolve the dilemma of managing current and new public health risks in the face of budgetary pressures, as well as to correct known problems in the drugs and medical devices programs. We undertook this audit to assess the early successes of the change initiative.

Scope

28.40 Our follow-up consisted of reviewing status reports prepared by the Branch on the progress it had made in responding to our observations and recommendations. We also interviewed selected Branch officials and reviewed supporting documentation.

Conclusion

28.41 The Branch has taken some action on all of our observations and recommendations. However, in most areas, additional work remains to be done to fully address our concerns. Further, it is still early to assess the impact of some initiatives that have only recently been implemented or are in the process of being implemented.

28.42 The pressure for change due to reduced budgets and growing public expectations concerning the management of health risks continues for the Branch. Past renewal initiatives have been succeeded by a new process of renewal, Health Protection Branch Transition. Some projects under way at the time of our 1995 audit have been completed. Other projects remain outstanding and have been incorporated into the new process of renewal.

28.43 Action taken by the Branch to improve information on the effectiveness of its programs has yet to be translated into improved performance information. The Branch needs to complete its revised risk management framework, for use in better allocating resources and setting priorities. In some areas where revenue generation opportunities were identified, revenue is not yet being collected. Changes have been made to address known problems in the drugs program, such as enhancing the submission tracking system. The Branch recognizes that further changes are required in streamlining the assessment process. Regulatory changes to improve the management of risks associated with drugs have not yet been fully implemented.

Observations

Overall momentum of change at the Branch

28.44 Audit observations in 1995. Our audit noted that by 1994 much of the early momentum of the re-engineering initiative had begun to dissipate. Other events, such as the government-wide program review, diverted attention and energy from the process.

28.45 Follow-up observations. Since our last audit, there have been organizational changes in the Branch, such as the amalgamation of the drugs program and the medical devices program to form the Therapeutic Products Program. The Branch has also begun a new process of renewal, Health Protection Branch Transition. Work is focussing on five areas — legislative renewal, the surveillance core, the science core, the risk management framework, and program development. The Branch initiated this three-year process in 1997 to respond to continuing challenges, such as resource constraints, and to new challenges, such as the pressures of increasing globalization on public health. The Branch expects the Transition initiative to re-create the early momentum of the re-engineering initiative and to deal with the many challenges it continues to face.

28.46 In addition, the Department established a Science Advisory Board in December 1997 to provide independent advice to the Minister of Health on how best to position the scientific, technical and policy aspects of Branch programs, now and in the future. Its responsibilities include advising on ongoing measures required to ensure that the Branch science retains the confidence of the public, and advising on the scientific and technical adequacy of Branch programs, procedures, methodologies, protocols and tests.

Observations on individual projects

28.47 Many of the projects under way at the time of our 1995 audit have been completed. Others have yet to be implemented or have been incorporated into the new process of renewal.

Information on the effectiveness of Branch programs

28.48 Audit observations in 1995. We found that the absence of information on the effectiveness of Branch activities provided a weak foundation for efforts to assess public health risks and to rationalize budget allocations. We recommended that the Branch improve the information available on the effectiveness of its programs.

28.49 Follow-up observations. Our follow-up review found limited progress made by the Branch in producing improved information on the effectiveness of its programs. The Branch initiated a project in December 1995 to develop an outcomes-based program performance framework that would allow comparison of actual results with established objectives for a program. The framework was applied in pilot tests in individual directorates within the Branch and received management endorsement in July 1997. At the time, the Branch stated that further work was required to complete the framework, including identifying data that could be collected, analyzed, and used to produce key information about the program being examined.

28.50 At the time of our follow-up, the Branch had not yet implemented the framework throughout the Branch. As a result, although individual directorates have started preliminary work to collect better effectiveness information, to date the framework has not resulted in improved information on the effectiveness of Branch programs.

Risk management and priority setting

28.51 Audit observations in 1995. We recommended that the Branch improve its approach to the management of public health risks for use in allocating resources and setting priorities. The Branch agreed, stating that this was a key component of its plans to strengthen its evidence-based approach to priority setting and risk management.

28.52 Follow-up observations. Our follow-up review confirmed that while the Branch has done work on a revised risk management framework, it is not yet complete. A draft framework was presented to the Branch's senior management in December 1997. Working groups were then established to develop guidelines to implement the framework. Implementation will begin in 1999, with full implementation sometime in 2000. In addition, while a general framework for priority setting and resource allocation has been completed and directorates within the Branch have undertaken work to determine their individual priorities, this work has not been consolidated at the Branch level.

Revenue generation

28.53 Audit observations in 1995. In our 1995 audit, we observed that the Branch had developed a revenue plan identifying 18 activities where user fees could be implemented between 1994-95 and 1997-98. The plan estimated potential gross revenues of \$90 million over this period, with an initial outlay of \$35 million.

28.54 Follow-up observations. The Branch is collecting revenues in 13 of the 18 activities it had identified. Of the remaining five activities, two were subsequently deemed unsuitable for revenue generation, while the remaining three are expected to start generating revenues by 1999-2000. The Branch collected \$86.5 million in revenues between 1994-95 and 1997-98. Revenues from one activity — drug evaluations and submissions — were higher than expected due to a change in the fee structure and a greater number of submissions than anticipated. This has increased total revenues to a level near the original estimate.

Drug approval

28.55 Audit observations in 1995. Our audit noted that in 1993 the Branch had initiated a strategy with specific projects designed to fix all problems known at that time in the drug approval process. All projects were scheduled to be completed by August 1995. Examples of projects discussed in the 1995 chapter that were not complete at that time were the need to streamline the assessment processes for certain categories of drug products, including high-risk products, the implementation of improvements to the emergency drug release program, and the reduction in the backlog of drug submissions. In particular, the Branch stated that eliminating the backlog would become the priority of the renewal program during 1995.

28.56 Follow-up observations. Our follow-up observations focus on the examples cited in our 1995 audit. Our review confirmed that the Branch has taken steps to streamline the assessment process for drug products. It enhanced its electronic submission tracking system and developed electronic templates for filing comprehensive summaries of submission data. As well, the Branch revised a number of its policies to improve the assessment process. For example, it updated its management of drug submissions policy in 1997 to outline changes in the way it intended to manage information on drug submissions forwarded by drug manufacturers. The Branch told us that it was currently examining the process for reviewing drug safety, efficacy and quality in order to ensure that the assessment process continues contributing to improved performance.

28.57 The Branch has taken steps to streamline the assessment process for drug products; however, several regulatory changes, which the Branch states will improve the management of risks, have not yet been fully implemented. These include changes to the drug product licensing framework.

28.58 The Branch has not yet finalized changes to improve the process it uses to release drugs on an emergency basis. In September 1996, the Branch advised the Public Accounts Committee that it had proposed changes to

streamline the process and enhance the compassionate access component of the program, to be implemented late in 1996. Although some initial changes have been made, such as issuing a new policy, full implementation is on hold pending finalization of regulatory changes, anticipated during 1998-99.

28.59 Our review of actions taken to reduce the drug submission backlog found that the backlog remains a concern. In March 1996, the Department updated performance standards for drug submission review, and the Branch now issues a report outlining its performance in reviewing drug submissions. However, between December 1995 and December 1997, while the median approval time for new drug and abbreviated new drug submissions had decreased from 23.2 months to 19.3 months, the backlog had increased by 24 percent. The Branch has indicated that increases in other types of submissions have required significant resources. It also recognizes, however, that the increase in the backlog must be addressed, and it is investigating the causes of the increase.

Medical device approval

28.60 Audit observations in 1995. We observed that program weaknesses relating to medical devices were known, but many would not be dealt with until a proposed regulatory package comprising changes in 16 different areas was implemented. At the time, the Branch expected the new regulations to be implemented by 1997.

28.61 Follow-up observations. Our follow-up review found that while implementation has been slower than expected, new regulations took effect in July 1998. The regulations address the majority of the 16 areas, including enhanced pre-market scrutiny, product and establishment licensing, a risk-based classification system, phased introduction of a quality systems approach, and mandatory reporting of problems with devices. The regulations contain several transitional provisions, meaning full implementation has not yet occurred.

Public Works and Government Services Canada — Northumberland Strait Crossing Project — 1995, Chapter 15

Assistant Auditor General: Shahid Minto
Principal: Hugh McRoberts

Background

28.62 Our 1995 audit of the Northumberland Strait Crossing project (now the Confederation Bridge) focussed primarily on procurement, financial analysis, taxation, environment and reporting to Parliament. Our intention was to provide an early warning to Parliament about any significant potential problems and to encourage any improvements that could be made. The audit covered the planning and implementation phases of the project up to July 1995.

28.63 We drew several conclusions, one of which was that the project's environmental aspects were being handled within the intent of the Environmental Assessment and Review Process. Overall, we made no recommendations, but stated that we would monitor the project, specifically with respect to environmental issues and the overall results of the bridge construction.

28.64 The Confederation Bridge was officially opened, on schedule, on 31 May 1997.

Scope

28.65 We limited our follow-up to environmental matters and to tolls. For the former, we wanted to assess whether the government was continuing to manage the project's environmental aspects appropriately. Our follow-up on tolls looked at whether the government, in approving the toll schedule, had complied with toll provisions set out in the original agreements signed in 1993 between the government and the developer, Strait Crossing Development Inc. (SCDI).

28.66 We reviewed supporting documentation, interviewed government and SCDI officials, and visited the completed bridge. We did not audit SCDI and express no opinion on its actions.

Conclusion

28.67 Based on our review, we conclude that since the time of our original audit, the government has been managing the project's environmental aspects appropriately and that the toll schedule approved by the government was in accordance with the Bridge Operating Agreement.

Observations

Environment

28.68 As a requirement of this project, the developer prepared an Environmental Management Plan (EMP) for the 35-year operating period. The overall Plan is a dynamic, life-of-project document that includes environmental protection and components for monitoring environmental effects. The EMP incorporates the Environmental

Protection Plan, which includes ongoing activities, and the Environmental Effects Monitoring Program, which tests predictions of impact and effects of mitigation on ecosystems.

28.69 The Department's Environmental Services Unit (acting as a service provider to the project) has conducted three compliance audits of ongoing operations since the start of construction. The most recent was conducted in the summer of 1996 and concluded that there were no exceptions to compliance with federal, provincial and municipal regulations and guidelines. A fourth compliance audit was scheduled for the summer of 1998 and will involve the operation phase. The audits were conducted by experienced personnel who used criteria developed through extensive environmental studies and consultations, and reviewed relevant regulatory requirements. We noted that the audit criteria make reference to the Environmental Protection Plan and the relevant regulations. Our review of the most recent environmental audit findings found that they were relatively clear and straightforward, but that the audit was not conducted by an independent third party. Consequently, there is a possibility of conflict of interest, although we found no evidence of this in our follow-up.

28.70 During construction, the government and developer issued an information booklet on environmental matters affecting the project. In addition, the project's Environment Committee issued an update report in the spring of 1997, noting that there had been no exceptions to compliance.

Tolls

28.71 The Bridge Operating Agreement, signed as part of all the original 1993 project agreements, includes provisions related to the setting of initial tolls, to modifications and to yearly increases. The Agreement also states that all toll revenue must be deposited in a trust account, and reported periodically to the government. The developer may withdraw funds for operating expenses and minor capital expenditures. The excess may be withdrawn from the trust account provided that all provisions in the agreement have been satisfied. The government has the right to audit all related records.

28.72 There is also a toll shortfall clause within the Agreement that permits the developer to apply to the government for recovery of amounts in the event that revenues collected are less than the 1992 ferry revenue indexed to 31 December of the preceding operating year. Yearly toll increases are limited to 75 percent of the increase in the Consumer Price Index.

28.73 Although the developer is protected against toll revenue shortfalls, there are no provisions limiting the total toll revenue that can be collected in any period. The government's intent was to encourage the developer to operate efficiently and increase toll revenues by attracting additional traffic. It was also expected that the developer would invest profits in the local economy.

28.74 The Agreement required the developer to submit an initial toll proposal no later than six months prior to the opening of the Bridge. It specified that tolls set in the initial year of operation shall be "substantially the same as" 1992 annual ferry revenue indexed to 31 December 1996, using the Consumer Price Index. The government had established this figure to be \$13.9 million.

28.75 Toll negotiations between the government and the developer revolved around two crucial elements: toll rate and toll structure. The toll rate is the amount charged for each vehicle/individual for a round trip use of the bridge. The toll structure establishes vehicle categories (car, bus, truck, etc.).

28.76 During the period of January to May 1997, several toll proposals were submitted to the government by the operator. Each was in turn rejected by the government, primarily because the total estimated annual toll revenue from each proposal would have exceeded the base figure of \$13.9 million. The developer submitted a final proposal shortly before the bridge opened. While the estimated toll revenues still exceeded the base figure, the variance was

less than 10 percent, an amount that was deemed to be within the discretion implied in the Agreement by the phrase “substantially the same as”. Accordingly, the government approved the rate structure contained in this proposal.

The Implementation of Federal Environmental Stewardship — 1996, Chapter 2

Commissioner of the Environment and Sustainable Development: Brian Emmett Principal: Wayne Cluskey

Background

28.77 In May 1996, our Office reported on the government's federal environmental stewardship (greening) initiative. We focussed on three aspects:

- the departmental and agency responsibilities under the Code of Environmental Stewardship, including the leadership role of Environment Canada in the implementation of the initiative;
- information dissemination, accessibility and management; and
- the government's ability to demonstrate progress toward the greening of all of its operations.

Scope

28.78 As part of our follow-up, we reviewed two Environment Canada status reports on actions taken — one report prepared in July 1997 for the Public Accounts Committee and a second prepared in July 1998 at our request. We conducted interviews with departments and agencies, and reviewed supporting documentation to assess the extent of progress up to 18 August 1998.

Conclusion

28.79 Although the federal government, with Environment Canada as facilitator, has made progress in response to our observations and recommendations, there remain several important issues that need to be addressed. There is the question of whether the Code of Environmental Stewardship is still in effect for those agencies that did not produce sustainable development strategies and, if not, the impact this has had, or is having, on the government's environmental greening initiatives in these agencies. We also noted that none of these agencies are represented on the Federal Committee on Environmental Management Systems, even though one of the objectives of this committee is to provide assistance in the development and implementation of the government's greening initiative.

Department's response: *Environment Canada agrees with the audit finding that there is a gap between those departments required to submit sustainable development strategies under the amendments to the Auditor General Act and those federal agencies and Crown corporations where the Act does not apply. Environment Canada has an important role to play in encouraging federal agencies and Crown corporations to adopt good environmental management practices. As part of this role, Environment Canada, with the co-operation of the Federal Committee on Environmental Management Systems (FCEMS) and the active participation of the Office of the Commissioner of the Environment and Sustainable Development, will conduct a best practices workshop in the next year for agencies and Crown corporations. The objective of the workshop will be to provide them with information on the government-wide greening initiatives.*

Observations

Is the Code of Environmental Stewardship still in effect?

28.80 In May 1996, we noted that although the government had moved the greening process forward for departments and designated agencies with amendments to the *Auditor General Act* to require sustainable development strategies, the Code of Environmental Stewardship continued to apply to most agencies. It should be noted that these amendments do not apply to Crown corporations and most agencies. There was, and continues to be, no further guidance for implementation of the Code. There is also no definite indication whether the Code continues to apply to those organizations not included in the amendments.

28.81 The implementation of sustainable development strategies (SDSs), tabled by departments and some agencies in December 1997 as required by these amendments to the *Auditor General Act*, will advance the government toward its goal of greening. However, follow-up interviews in two large agencies that have not produced an SDS, indicated that their greening activities have not advanced since our original audit in 1996. One agency has failed to update its environmental action plan, as required by the Code, and there have been no progress reports, while another agency has yet to produce an environmental action plan. In our opinion, this indicates that in those agencies not producing an SDS there is a significant risk that the environmental stewardship initiative has lost momentum and direction.

28.82 Environment Canada, in its status report of July 1998 to the Auditor General, stated that “further clarification between the activities carried out under *the Auditor General Act* vs. the Code [is] no longer required”. This does not answer the question as to whether the Code is still in effect and whether it should continue to be applied by those agencies not required to produce a sustainable development strategy.

Can the sharing of information and experiences be expanded?

28.83 Immediately prior to its closure on 31 March 1997, the Office of Federal Environmental Stewardship (OFES) conducted a series of workshops across Canada, entitled “Greening Government Operations: The New Imperative”. These workshops were designed to assist federal departments and interested agencies in meeting their new greening obligations. However, there has not been any follow-up to assess the extent to which departments and agencies were reached, and whether those agencies that were not required to prepare an SDS were in a position to obtain guidance if needed.

28.84 Even with the closing of the OFES, Environment Canada continues to have leadership responsibilities. They continue to be exercised through the Federal Committee on Environmental Management Systems (FCEMS), a working group of the Environmental Accountability Partnership (EAP); it is composed of departments and agencies, the Treasury Board Secretariat and Environment Canada. In our opinion, Environment Canada’s involvement and leadership are fundamental to the effectiveness of the FCEMS.

28.85 The FCEMS has a mandate to further sustainable development and support the commitments of the Code of Environmental Stewardship. The objectives of the FCEMS include developing action plans, tools and mechanisms, and assisting in the development and implementation of the government’s greening initiative. However, only those departments and agencies that have tabled an SDS in the House of Commons are in fact represented on the FCEMS. We encourage the FCEMS to exercise its mandate with respect to the greening of all government organizations.

28.86 The FCEMS has recently developed a website that captures minutes of meetings, categorizes greening information and provides links to other websites. In our opinion, this development is a step in the right direction, providing that those entities needing guidance are aware of the existence of the website, can access the information

easily and can benefit from its content. We note, however, that Environment Canada does not know which departments and agencies are accessing this site at present and, more important, whether the information provided is fulfilling their needs.

28.87 In our opinion, the opportunity exists for departments and agencies, through the FCEMS, to capture and communicate results and best practices among themselves. As with most environmental challenges, the key to success is senior management commitment and the communication of that commitment to all employees.

Can the government achieve its goal to green all of its operations?

28.88 Departments and agencies that were required to table a sustainable development strategy, and those that have done so voluntarily, have already benefited or will benefit from a detailed review by the Commissioner of the Environment and Sustainable Development. As noted in the Office of the Auditor General’s own SDS, the Office is committed to encouraging federal organizations that are not required to develop an SDS to do so, or to report on sustainable development issues using other means. Exhibit 28.2 identifies the 28 agencies with more than 100 full-time equivalents that are not required to prepare an SDS and that have not done so voluntarily. These agencies comprise 40 percent of the total agency work force of 58,900 full-time employees, and 8 percent of the total government work force of 282,000 full-time employees, excluding Crown corporations.

Exhibit 28.2

Agencies With More Than 100 Full-Time Equivalents (FTEs) That Are Not Required to Prepare a Sustainable Development Strategy and That Did Not Voluntarily Prepare One

	Staff (FTEs)	Budget (\$ millions)
Atomic Energy Control Board	410	47
Canada Labour Relations Board	107	9
Canadian Centre for Management Development	133	17
Canadian Food Inspection Agency	4,414	248
Canadian Grain Commission	745	50
Canadian Human Rights Commission	181	14
Canadian Radio–Television and Telecommunications Commission	415	33
Canadian Security Intelligence Service	2,030	161
Canadian Space Agency	390	185
Canadian Transportation Accident Investigation & Safety Board	241	22
Canadian Transportation Agency	260	22
Federal Court of Canada	431	32
Immigration and Refugee Board	998	77
National Archives of Canada	607	46
National Energy Board	300	28
National Film Board	570	67
National Library of Canada	437	30
National Parole Board	335	24
National Research Council of Canada	3,010	462
Natural Sciences and Engineering Research Council of Canada	191	434
Office of the Commissioner of Official Languages	126	10
Office of the Coordinator Status of Women	109	17
Office of the Superintendent of Financial Institutions	429	46

Privy Council Office	662	64
Public Service Commission	1,344	121
Statistics Canada	4,520	262
Supreme Court of Canada	144	15
Tax Court of Canada	126	10
TOTAL	23,665	2,553

Source: Canadian Ministry Index — Government of Canada Internet Site, June 1997
(not audited)

28.89 As reported in 1996, Crown corporations, which constituted over 30 percent of the government organizations contacted by the Office of Federal Environmental Stewardship in 1992, remain formally excluded from the greening process under either the Code of Environmental Stewardship, or the amendments to the *Auditor General Act*. Although excluded, Crown corporations were encouraged by Environment Canada to adopt the Code of Environmental Stewardship in their operations. We suggest that the FCEMS contact Crown corporations in an attempt to persuade them to participate in this process, and thereby achieve government-wide application of the greening process, as was the federal government's original intention under the 1990 Green Plan.

Internal Audit in Departments and Agencies — 1996, Chapter 4

Assistant Auditor General: Doug Timmins

Director: Bruce Sloan

Background

28.90 In May 1996 we reported the results of our audit of the internal audit function in federal departments and agencies. We concluded that the quality of internal auditing varied considerably from one organization to another and that internal auditing was not making progress in closing the gap between what might reasonably be expected from the function and its actual performance.

28.91 Our 1996 chapter focussed on five areas:

- the level of management support provided to internal audit;
- audit coverage, that is, the departmental operations that internal audit examined;
- how internal audit groups were measuring their own performance;
- senior management's use of the recommendations in internal audit reports; and
- the extent to which the Treasury Board Secretariat was fulfilling its role as functional leader of the internal audit community.

28.92 Since we reported our findings, the Report of the Independent Review Panel on Modernization of Comptrollership in the Government of Canada has been released. This important initiative establishes an understanding of what modern comptrollership should be within the federal government and describes how comptrollership can contribute to improved management practices within federal government departments. The Panel's report describes an increasingly important role for internal audit within modern comptrollership.

Scope

28.93 Our follow-up audit work consisted of a review of key documents from internal audit groups in a sample of departments across government. We also conducted interviews with Heads of Internal Audit and with officials of the Treasury Board Secretariat to discuss and assess actions taken in response to our 1996 recommendations.

Conclusion

28.94 Overall, we have noted improvement in the quality of internal auditing in the federal government. However, further efforts will be needed to ensure consistent quality of internal audit across all government departments and to fulfil the role envisaged in the Report of the Independent Review Panel on Modernization of Comptrollership. Implementing the recommendations of the Panel needs to be a priority of the government to help ensure that a high-quality internal audit function is demanded and provided across government.

Observations

Senior management support

28.95 Since our audit was completed in 1996, we have noted a more active involvement of the senior management of departments in departmental audit committees. Their activities consist of approving the planned audit coverage of internal audit, reviewing the recommendations contained in the audit reports and monitoring actions taken in response to the recommendation, and the establishment of audit committees where they did not previously exist. These activities provide visible senior management support for the internal audit function and therefore are an important step in establishing effective internal audit in departments.

28.96 As departments implement the recommendations of the Panel on Modernization of Comptrollership, their understanding of the role that internal audit can and should play in an organization will become increasingly important.

28.97 We did not note any instances where departments had adopted our recommendation to implement the private sector practice of appointing members who are not public servants to their departmental audit committees. We believe that implementing this recommendation would strengthen the role and independence of internal audit.

Scope of internal audit coverage

28.98 In general, we noted an improvement in the extent to which internal audit groups have adopted audit coverage of broad scope in accordance with Treasury Board Secretariat and professional standards. In 1996 we reported that while the majority of internal audit coverage focussed on areas of financial and administrative systems, there was only limited coverage of issues related to efficiency of operations and achievement of established operational objectives.

28.99 As part of our follow-up work, we reviewed a sample of internal audit reports to determine the type of internal audit coverage being carried out. Our review indicated that departmental internal audit groups are taking positive steps to include in their audit coverage audits that focus on assessing the achievement of established operational objectives. In general, such audit work was focussed on objectives within individual operating units. Further progress will be needed to meet the challenges created by the Report of the Panel on Modernization of Comptrollership.

Measuring the performance of internal audit

28.100 In 1996 we reported that approximately half of the internal audit groups had either formal or informal mechanisms for measuring their performance. We also reported that the Treasury Board Secretariat had not reviewed the departmental implementation of its audit policy and standards or the effectiveness of internal audit. Our follow-up audit work indicated that this remains essentially the same today.

Role of the Treasury Board Secretariat

28.101 In 1996 our report raised concerns about the clarity of the government's Review Policy and the confusion that it introduced about what internal audit should be doing. The Report of the Panel on Modernization of Comptrollership also noted a need to clarify the role of internal audit.

28.102 While specific actions have not yet been taken, the Treasury Board Secretariat has indicated its intent to carry out a number of initiatives that will:

- provide direction for the future evolution of internal audit in support of modernized departmental comptrollership;
- recommend changes to the existing policies and standards for internal audit in the federal government, and/or in the way government applies them; and
- examine current and alternative staffing patterns for internal audit in relation to the desired policies and standards, and recommend actions and options for central agencies and for individual departments.

28.103 The Treasury Board Secretariat has stated that it plans to complete these initiatives by 30 September 1999. We will continue to monitor the progress and outcomes of these initiatives and the implementation of the Panel's recommendations on modernizing comptrollership.

Peacekeeping — Foreign Affairs and International Trade and National Defence — 1996, Chapters 6 and 7

Assistant Auditor General: David Ratray

Director: Paul Morse

Background

28.104 Foreign Affairs and International Trade views peacekeeping as central to Canada's foreign policy objective of protecting Canada's security within a stable global framework. Over the years, Canada has participated in most peacekeeping missions.

28.105 The nature of United Nations (UN) peacekeeping has changed dramatically in the post-Cold War era. Before, the main role of the UN was largely to monitor truce agreements between states. Now the UN is increasingly called upon to carry out more complex missions that also involve a peace enforcement role, both between and within states. As well, a role for civil-military co-ordination and co-operation has emerged.

28.106 The Canadian Forces have been used extensively on peacekeeping missions. Canada has participated in nearly every United Nations peacekeeping operation as well as other multinational contingency operations, such as the Gulf War. Canadian Forces participation in peacekeeping and contingency operations is in support of the Canadian government's foreign policy.

28.107 At the time of our audit in 1996, over 2,000 Canadian Forces members were deployed on 12 missions, including the NATO Implementation Force (IFOR) in the former Yugoslavia. In 1998, Canada has participated in 11 UN peacekeeping missions. In addition, other international or multinational bodies are engaged in missions that support peace and stability, such as the Multinational Force and Observers in the Sinai, the NATO Stabilization Force (SFOR) in the former Yugoslavia, and participation in a United States-led force in the Arabian Gulf. Canada is also a participant in the UN's rapid reaction force.

28.108 Canada still has almost 2,000 troops deployed. In 1997-98, the estimated full cost of peacekeeping was \$496 million including UN, NATO, the Multinational Force and Observers. The incremental cost to National Defence is about \$140 million after UN payments are taken into account.

28.109 With respect to Foreign Affairs and International Trade, our 1996 audit addressed the adequacy of information for Parliament, the adequacy of information to ministers for decision making, the extent of Canadian efforts to reform the UN's peacekeeping function, the presentation of the overall cost to Canada of peacekeeping, and the quality of Canada's financial administration of peacekeeping reimbursements from the UN.

28.110 In regard to National Defence, our 1996 audit covered mission planning and information for decision making, the ability of the Canadian Forces to generate peacekeeping and contingency forces, and training and support to operations.

Scope

28.111 Our follow-up covered all subjects addressed in our original audit. We received progress reports from both departments, discussed them with officials and reviewed files and documents to substantiate departmental views or to investigate areas of interest to us. We did not repeat any of our original audit tests as part of our follow-up.

Conclusion

28.112 Foreign Affairs and International Trade continues to hold the view that it is inappropriate to designate a lead department to report to Parliament on peacekeeping. It has thus taken no action on our recommendation that the government name a lead department for that purpose. However, the Department has supported or co-operated with several national and international initiatives to acquire lessons learned and explore alternatives. It has also made efforts to make information on peacekeeping more available.

28.113 National Defence has been successful in addressing most of the internal management problems identified in our 1996 audit. It has greatly improved its internal processes for mission planning and has applied lessons learned. Training plans are being met, even though full brigade training is no longer planned. Equipment has been improved and medical support plans have been made more realistic. Control over deployed materiel has also been much improved.

28.114 One major problem has not been resolved: adequate strategic reconnaissance is not being conducted prior to deployment for all missions. This increases the risk of mission failure.

Observations

Recommendations to Foreign Affairs and International Trade

28.115 Chapter 6 of our 1996 Report examined the role of Foreign Affairs and International Trade in peacekeeping. We recommended that the Department:

- conduct a “standback assessment” in co-operation with other government departments and non-governmental organizations to determine what lessons have been learned;
- consider other possible ways in which Canada could participate in peacekeeping to meet Canada’s objectives, given the fiscal realities in Canada and the UN; and
- ensure more public articulation of the nature and extent of participation in specific missions and the potential for obtaining benefits that Canada wishes to derive. (We noted that better information on the implications and results of peacekeeping efforts was needed.)

28.116 Departmental officials have told us that the Department feels it cannot allocate a high level of resources to peacekeeping activities. It has not taken the approach of leading a major effort to assess Canada’s role in peacekeeping. However, it has taken several initiatives that respond to our recommendation, including the following:

- The Department has supported a number of studies on lessons learned, including:
 - an international study on lessons learned from the UN assistance mission to Rwanda;
 - an in-depth review of how the Department performed as a government department in the Zaire crisis; and
 - papers presented to a conference and intergovernmental meeting on peacekeeping held in 1997 at the University of Halifax.
- The Department has supported the UN Lessons Learned Unit financially and through the Permanent Mission in New York.

28.117 Foreign Affairs and International Trade has participated in several ways to consider alternatives to current peacekeeping methods and help avoid future conflicts. It has taken the leading role in promoting a treaty for a comprehensive ban on anti-personnel land mines. It has created with CIDA a \$10 million “Peacebuilding Fund”. It has also been involved in a number of smaller activities such as providing \$2.5 million to support the Organization for African Unity’s Mechanism for Conflict Prevention, Management and Resolution, and co-chairing the Friends of Rapid Deployment Group in New York.

28.118 Foreign Affairs and International Trade and National Defence provide information to ministers on the implications of a given peacekeeping mission, through aide-memoires that are classified documents to which our Office has only limited access. Foreign Affairs and International Trade claims that the information therein is comprehensive. In addition, it has put information on peacekeeping missions and peacebuilding on its Internet website, but there is little information on the benefits to Canada. The Department has also made efforts to inform parliamentarians through documentation, briefings and visits.

28.119 Our 1996 Report recommended that the government name a lead department to report to Parliament on all significant aspects of Canadian participation in peacekeeping, and specifically on:

- all significant costs;
- additional ways, if any, that were considered for participation in UN peacekeeping; and
- efforts made toward UN reform related to peacekeeping and the results achieved.

28.120 Foreign Affairs and International Trade responded to that recommendation by stating in our Report that it would be inappropriate to designate a single lead agency. The Department maintains that view, and has taken no action.

Collections from the United Nations

28.121 Our 1996 chapter on peacekeeping relating to Foreign Affairs and International Trade noted that National Defence had taken responsibility for billing the UN for reimbursements and for their collection. The UN reimburses Canada for troop costs, Letters of Assist (such as use of Canadian Forces aircraft), consumable supplies and equipment depreciation. Additionally, claims can be made for death and disability compensation benefits. We noted that billing and collecting was hampered by the difficulty of obtaining the required documentary evidence from in theatre as well as by the complexity of UN systems and requirements. The UN also has a chronic shortage of funds. We concluded that improvements were possible in the administration of reimbursements from the UN.

28.122 National Defence has assigned a full-time staff person to Canada’s Permanent Mission to the UN in New York to deal with claims. For each peacekeeping mission, it now negotiates with the UN a Memorandum of Understanding for Contingent-Owned Equipment. This should prevent some of the serious delays experienced in the past and allow for more accurate estimation of revenue. National Defence recorded revenues of \$32.4 million for 1996-97 and \$41.5 million for 1997-98, despite a drop in UN peacekeeping activity.

28.123 Our 1996 audit recommended that National Defence actively pursue the submission and settlement of claims relating to death and disability. Since then, the Department undertook to recover funds on death, disability and medical claims. Progress has been evident but slow, in part due to the nature of the claims. National Defence completed 16 death claims in 1997 and received \$7.6 million. Another \$200,000 is outstanding. Preparation of disability claims started in May 1997. To date, 10 disability claims have been submitted to the UN for a total of \$7.4 million. A further 30 claims are in progress with an estimated value of \$4 million. Development of medical claims started in November 1997. To date, 18 claims have been submitted to the UN with a total value of \$1.2 million. A further 33 claims with a total value of about \$1 million are in progress.

Mission planning

28.124 Our 1996 audit found that there had been gaps in deployment planning by the Department of National Defence. We did not find written assessments of whether proposed missions had clear and achievable mandates. The Department had not conducted comprehensive written assessments of each rotation that addressed the feasibility and likelihood of success of the overall mission. Moreover, full reconnaissance — essential to the ability to assess the feasibility and requirements of a mission — had not been carried out for the initial deployment to Bosnia or for the first rotation to Rwanda. We recommended that the Department complete improvements in its staff procedures to resolve these problems.

28.125 Our follow-up found that the Canadian Forces have finally completed major improvements in their staff processes. Detailed staffing procedures for mission planning were approved in April 1998. Nonetheless, staff inspection visits were routinely conducted to each mission in the first month of deployment. Most significantly, the Department has implemented a “lessons learned” process that collects standardized reports from each mission, assesses the relevant lessons and ensures that mission planners have them available for planning each new mission.

28.126 Despite these improvements, adequate strategic reconnaissance was not carried out for the three largest missions conducted since 1996: OPERATION PALLADIUM, the deployment of a battalion group to the former Yugoslavia; OPERATION ASSURANCE, the establishment of a multi-national force headquarters in Entebbe and later Kampala, Uganda to address the plight of Rwandan refugees in Eastern Zaire; and OPERATION STANDARD/STABLE, the deployment of a battalion-size force to Haiti. Officials told us that “strategic reconnaissance” is reconnaissance aimed at providing information on which to make a decision of whether to deploy, while “tactical reconnaissance” is intended to provide information regarding how to deploy.

28.127 The Department now recognizes that the Canadian Forces do not have the ability to gather the necessary information on which to base clear high-level mission guidance. This can create a “strategic planning vacuum”, rendering Canada vulnerable to the agendas of other states. In part, strategic reconnaissance is not undertaken because the government commits itself to missions before field work can be undertaken. Officials indicated that the government is hesitant to visibly involve the Canadian Forces at an early stage because it might appear that Canada is already committed and thus it would be more difficult not to participate. The Department has advised us that it is considering initiating discussions with other government departments in order to address this problem.

Generating peacekeeping and contingency forces

28.128 Equipment adequacy. Our peacekeeping audit reported that in 1995 the Canadian Forces had concluded that long-standing deficiencies in equipment would not allow troops to perform assigned missions within an acceptable level of risk. In August 1995, the government decided to replace and refurbish the fleet of armoured personnel carriers. It ordered 360 new light armoured vehicles and is considering the Department’s request for an additional 291.

28.129 Our follow-up found that the contract for replacement is proceeding as planned. The first of the 360 new light armoured vehicles, now called the LAV-3, has been delivered for testing. The remainder will arrive in 1999 and 2000. The Army conducted an equipment rationalization plan in 1997 and concluded that the number of M113s to be refurbished could be reduced from 773 to 406. The remainder will be sold. Effective approval by the Treasury Board for the M113 and Grizzly refurbishment projects is expected in the fall of 1998.

28.130 Our 1996 audit recommended that National Defence prepare and make available to decision makers a fully documented assessment of risk when considering the use of the current armoured personnel carriers and tank trainers in peacekeeping operations. The Department agreed.

28.131 Officials told us that no new missions since 1996 have required these vehicles. The same fleet has remained in Bosnia. We reported in 1996 that additional armour had been added to those vehicles in 1995. Since that time, further protection such as spall liners has been added to one type of personnel carrier — the M113. We did not attempt to assess the impact of the additional armour on the mobility of the vehicles, which had been noted as a problem in our audit. However, officials told us that completed and planned initiatives to improve vehicle power and suspensions would reduce the effect of the added weight.

28.132 Health services. Our 1996 audit concluded that even with a proposed increase in capacity to a 200-bed field hospital to treat casualties, the Canadian Forces would not be able to deploy the minimum force described in the 1994 White Paper without arranging with allies for medical support. For peacekeeping operations, Canadian troops had often relied on medical support provided by other countries, a normal method of operation for all participants in UN missions. We concluded that the Canadian Forces had not properly justified the number of beds it planned to add.

28.133 Our follow-up found that the Department has completely revised its plans for health service support. It reoriented its analysis to providing medical support for low-level operations across the full spectrum of operations other than war, including peacekeeping. The analysis concluded that for those needs, a modularized field hospital of about 130 beds would be required. Officials project that such a facility will be operational by the year 2004.

28.134 Tasking of personnel. Our 1996 audit found that overall, peacekeeping had not put an excessive burden on individual members of the Canadian Forces. Roughly 80 percent of personnel had served only one six-month tour in a five-year period.

28.135 In 1996 we examined the 1994 White Paper allowance of 3,000 additional personnel for the Army field force. Of the 3,000, 1,600 were added by cancelling planned cuts. National Defence conducted a comparison between manning levels in November 1994 and June 1998 and concluded that the Army field force had increased by over 3,000 personnel.

Reserves

28.136 Our 1996 audit reported that the Militia had not overcome training problems first noted in 1992. On peacekeeping troop rotations in 1994 and 1995, about 20 percent of Militia personnel selected for peacekeeping missions were unable to pass the selection training and evaluation at the lowest level of required individual skills. We therefore reviewed post-operation reports on peacekeeping rotations to Bosnia, Rwanda and Haiti. In 3 of 7 rotations, problems were noted with the training of Reservists volunteering for peacekeeping missions. The Army was unable to provide information on Reserve training overall to indicate whether there had been a general improvement. The Department noted that because training deficiencies are identified and addressed prior to deployment, it regards the risk to be acceptable.

28.137 Training. In 1996 we found that predeployment training was often inadequate. Units were developing their own training in an unco-ordinated manner and peacekeeping experience was not passed from contingent to contingent or among Commands. Some areas of repeated weakness were noted in mission reports, indicating a poor lessons-learned and training system. Individuals were sometimes deployed even though they had not been fully or consistently trained. We recommended that National Defence develop adequate predeployment training standards and disseminate lessons learned more efficiently.

28.138 The Department has taken action on this recommendation. It issued a Course Training Standard in 1997 for both individual and collective peacekeeping training, and has assessed and revised it since. The Department has also increased central control over the selection and training of individuals for peacekeeping operations.

28.139 In order to improve the dissemination of lessons learned, the Department has completed the implementation of its lessons learned process. It has also established a Peace Support Training Centre responsible for predeployment training of individuals, and has co-ordinated training development with the Pearson Peacekeeping Centre at Cornwallis.

28.140 We reviewed all post-exercise, post-operation and lessons learned reports filed with the Army Lessons Learned Centre in Kingston since 1996. We found that most — if not all — of the individual training deficiencies we noted in 1996 appear to have been corrected. However, lack of adequate strategic reconnaissance and high-level direction during the planning phases of missions has the potential to disrupt training. For example, in the case of OPERATION ASSURANCE to Central Africa, about 300 troops were deployed before being declared operationally ready. This could have resulted in deployed personnel encountering situations for which they had not been trained.

28.141 Our 1996 audit included the overall collective training program of the Army that supports its general ability to deploy troops. We concluded that peacekeeping operations and budget reductions had resulted in a decline in collective training and had impaired operational readiness. We recommended that the Land Force clarify its concept of readiness, that standards be put in place, and that the Land Force address its inability to complete collective training plans.

28.142 The Department has told us that it has clarified its concept of operational readiness through the issue of a Land Force Order specifying how units are to be declared operationally ready. The Land Force is continuing to implement its performance measurement system. It notes that it completed a collective training exercise at the battle group level (about 1,000 soldiers) in May 1998.

28.143 Our follow-up found that the Army is now able to mostly complete its overall collective training program, but that the program is still concentrating below the brigade level. Current plans call for a composite brigade to be formed if required as a contingency force. The Army therefore trains battalions and brigade headquarters separately, with a view to deploying them together should the need arise. While Army officials believe they can meet 90-day deployment requirements, separate training increases the risk that more time might be required.

28.144 According to officials, units to be deployed are declared ready by the chain of command, using the Army's Battle Task Standards. They informed us that senior headquarters employ a training validation cell independent of the battalion being evaluated. They demonstrated that deficiencies are identified and reported to the Chief of the Land Staff.

Support to operations

28.145 Civil-military co-operation. Our 1996 Report observed that recent peacekeeping missions had clearly demonstrated the need for a sound working relationship with such agencies as the UN agencies, private volunteer organizations, local civic leaders and diplomatic staff to address effectively problems such as refugee handling. We recommended that the Canadian Forces ensure that doctrine addressing civil-military co-operation (CIMIC) be finalized quickly and be implemented through appropriate training in all commands. The Department agreed.

28.146 In the fall of 1997, the Canadian Forces Doctrine Board approved the Canadian Forces CIMIC Manual, which aims at the operational level. The manual must be interpreted and applied at the tactical level, where further work is being carried out. The Army has incorporated CIMIC into its collective training; the Pearson Peacekeeping Centre has developed a course on CIMIC; and the Canadian Forces Staff College is presenting the manual as part of officer training.

28.147 Canadian Forces personnel involved in CIMIC are currently deployed in Bosnia. The manual contains a number of recommendations to improve the implementation of CIMIC on missions; however, resource solutions have not yet been found.

28.148 Control of inventory and equipment. Our 1996 audit found that some important controls for inventory and equipment had broken down. We selected a sample of all downward adjustments and write-offs over \$100,000, with an additional 30 items at random. The Department could not find a significant proportion of the documentation we requested for our sample, and the adjustments remained largely unexplained. We also found a clear lack of inventory control over sea containers sent to one mission. We concluded that the Department had failed to apply the required control over items flowing through the supply system to peacekeeping missions. We also concluded that unexplained adjustments could represent real losses, placing departmental assets at considerable risk.

28.149 National Defence followed up on all the transactions in our sample and although it located much of the supporting documentation, it concluded that almost 28 percent of required documents were in fact unavailable and 30 percent of transactions had some form of error. The Department then conducted its own sampling for 1995-96 missions, and found that 24 percent of transactions still had some form of error. It concluded that this rate of error reflected a failure to apply standard supply policy and procedures.

28.150 Since our audit, the Department has made considerable efforts to regain control:

- Stock and equipment flowing to each mission must now bear a special identifying code in the supply system to permit an audit trail.
- After the first deployment to a mission, changes to the list of items required must go through an approval process.
- The central support unit in Montreal for deployed operations now has responsibility for all second-line items (those items not in current use by the deployed unit). This unit also controls all items acquired as “Unforecasted Operational Requirements”, thereby ensuring that these items are accounted for before being shipped.
- The central support unit in Montreal has instituted a bar coding system that identifies contents of all sea containers.
- Supply staff now participate in reconnaissance missions and are members of the advance party on missions. This smoothes the way for orderly accounting and control over assets on arrival in theatre.
- The Supply Directorate sends a staff inspection visit to each mission after deployment. These visits ensure that there is a full accounting of equipment and stock on hand and that all adjustments are properly approved and documented. Any discrepancies are reported and must be followed up. According to Supply officials, these visits have been very successful in ensuring control in the field.
- Better close-out and hand-over procedures between contingents have been instituted. In addition, automated inventory management and control have been extended to deployed operations.

28.151 In June 1998, the Deputy Chief of the Defence Staff signed a Direction to Commanders of Operational Deployments that includes a chapter on logistics and a chapter on close-outs. Those chapters have entrenched the improvements noted.

28.152 Staff Inspection Visits have resulted in a number of improvements and cost-saving initiatives. For example, on one mission, 8,000 out of 12,000 spare parts items were found to be dormant. The situation had persisted from one rotation to the next. The dormant items were returned to Canada where they could be used.

28.153 The Department has also improved training for supply functions on missions. Forces personnel have attended a course on UN supply procedures. As well, the Canadian Support Group has been offering predeployment training that has been well attended.

Agriculture and Agri-Food Canada — Animal and Plant Health — Inspection and Regulation — 1996, Chapter 9

Assistant Auditor General: Don Young

Principal: Neil Maxwell

Background

28.154 In May 1996, we reported observations and recommendations on the Animal and Plant Health program of Agriculture and Agri-Food Canada. These focussed on program delivery and design, performance measurement and cost recovery, cost avoidance and cost reduction initiatives.

28.155 In 1996, the government decided to consolidate animal and plant health activities and federally mandated food and fish inspection into a single federal agency. On 1 April 1997, the Canadian Food Inspection Agency began operations, assuming responsibility for safety and inspection activities that had previously been spread across three departments — Agriculture and Agri-Food Canada, Health Canada and Fisheries and Oceans. (Inspection activities held in Industry Canada were transferred to Agriculture and Agri-Food Canada prior to the creation of the Agency.)

Scope

28.156 The objectives of our 1998 follow-up were to determine the status of our 1996 recommendations, to identify actions taken and improvements made, and to note any other significant matters that came to our attention.

28.157 Accordingly, we reviewed and tested the July 1997 Department/Agency status report provided to the Standing Committee on Public Accounts in response to the 1996 chapter. We considered all the reported actions, focussing on those that addressed the 1996 recommendations, as well as actions taken subsequent to the July 1997 status report.

Conclusion

28.158 Over the last two years, much energy has been devoted to the creation of the Canadian Food Inspection Agency and to the integration of activities previously performed by the three departments. As noted in Chapter 12 of our September 1998 Report, a number of challenges had to be faced in creating the new Agency.

28.159 Since our 1996 Report, a number of initiatives have been undertaken to address our recommendations; however, work remains to be done. As many of our recommendations were long-term in nature, we did not yet expect the action required to be complete. While many of the actions that have been taken appear to hold promise of satisfying the recommendations, they were not sufficiently advanced for us to draw definitive conclusions that they will address our recommendations fully.

28.160 We encourage the Agency to continue its efforts to implement the applicable recommendations fully. Risk management, resource allocation, performance measurement and new ways of doing business are key to helping the Agency design and deliver programs that are efficient and effective.

Observations

Program design and delivery

28.161 As noted in our 1996 Report, the Agency has a scientific, systematic and rigorous basis for completing risk assessments. This process meets the standards of international treaties and conventions. The risk assessment process represents one aspect of the risk management process used by the Agency. We recommended several improvements to the risk assessment process, in both information gathering and assessment of information. The Agency has improved its information gathering by enhancing its surveillance activities and incorporating the resulting information into the risk assessment process. However, assessment of the economic impact of threats remains a concern. In the last several months, the Agency has taken some action that it believes will adequately address our concerns. The results of that action will become clear only when the Agency completes its efforts.

28.162 The 1996 Report recommended that risk assessments be completed for all regulated diseases and pests, as well as for other significant diseases, pests, weeds and toxic substances. This required the Department to adjust its focus from the assessment of import requests. The Agency has completed a number of these risk assessments, particularly related to diseases and pests. However, no risk assessments for weeds and toxic substances have been completed. This is despite the fact that in its 1996 response to our chapter, the Department made a specific commitment to carry out risk assessments for known toxic substances. Beyond the Agency's recognition of its responsibility for toxic substances, and the recent creation of a joint working group with Health Canada, little work on toxic substances has been done. Of particular concern is the fact that regulations still have not been developed to prescribe toxic substances, establishing the quantity or concentration allowable, based on risk assessment. With respect to weeds, management has told us that some effort has been given to developing the criteria and methodology for carrying out risk assessments on weeds of quarantine concern but that weeds are not an issue of concern.

28.163 An Agency-Wide Risk-Based Resourcing Project is currently in the conceptual stage. The intent is to create a process to ascertain, through consultation, the risk management priorities for Agency resources, and to identify management options to effectively and efficiently reduce the risks. Included in this project is a plan to prepare proposals for program redesign based on risk. This latter element of the project appears to address our 1996 recommendation related to the use of risk assessments in determining program-wide priorities and allocating resources. The project is a rather ambitious undertaking, one that has been attempted twice previously. The project has obtained senior management approval and will require several years to complete.

28.164 Over the last two years, changes have been made to the Resource Management System to provide additional information to assist in managing resources. These changes fall short of our recommendation to address the need for reliable management information. As part of its Year 2000 initiatives, the Agency is now developing a new system, the Multi-Commodity Activities Program. If implemented, this system would appear to address our concerns.

28.165 One of the cited benefits of creating the Agency was to enable the government to continue to build on and further develop its programs to provide a more efficient and effective food inspection system. This is consistent with our recommendation that the Agency further examine inspection and other activities with a view to identifying and implementing additional efficiencies in program delivery. The Agency has undertaken a number of major initiatives to achieve this goal. Examples include the Agency-Wide Risk-Based Resourcing Project, mentioned earlier, and the Integrated Inspection System, both of which are still in the conceptual stage of development. The intention of the Integrated Inspection System is to enhance efficiency and effectiveness in the inspection process.

28.166 Alternative service delivery mechanisms continue to be introduced to create additional efficiencies and greater effectiveness. The Business Initiatives Centre has been working with stakeholders and industry to create a more effective, uniform and streamlined inspection and certification system. The Agency-Wide Risk-Based

Resourcing Project and the Integrated Inspection System are new initiatives that are still under development. The alternative service delivery mechanisms and the Business Initiatives Centre are promising initiatives that have resulted in a number of new programs that were developed in co-operation with industry and stakeholders.

28.167 To date, the Agency has made limited progress in the areas of simulation exercises and updating of procedure manuals to assist with preparedness to respond to an incursion of a serious disease or pest. Nonetheless, staff of the Agency continue to receive training and experience. Over the last several years, Canada has contributed staff to a number of foreign countries to assist them in responding to incursions of diseases or pests. Several smaller-scale emergencies in Canada also provide training and experience. In June 1998, the position of Emergency Management Co-ordinator was staffed. This position was created with the goal of developing a single emergency response model for the Agency.

Performance measurement

28.168 Performance measurement provides for results-based accountability through the provision of information on accomplishments achieved against performance expectations and results commitments. This information is important for internal management to control operations and for parliamentarians to ensure accountability. Our 1996 chapter recommended that the Agency develop and use performance indicators, a component of performance measurement, to aid in identifying opportunities to improve the efficiency and effectiveness of program delivery. The Agency has developed a performance measurement framework, which was included in its Corporate Business Plan tabled in Parliament in 1998. Work continues on the development of performance indicators. Progress to date includes consultations with internal and external experts and the development of an implementation plan. We encourage the Agency to continue work on the indicators.

28.169 In 1996, we recommended that performance results, as measured by performance indicators, be reported to Parliament. We also recommended that other important information related to disease or pest outbreaks of critical significance and to the use of resources be reported to Parliament. Through its Corporate Business Plan and Annual Report, the Agency has provided some information to Parliament on performance results and disease and pest outbreaks. In doing so, the Agency has made progress in its reporting; however, development of the performance measurement process is still ongoing. Additional information on the significance of the diseases and pests that are reported would also be valuable. We encourage the Agency to continue its efforts to improve reporting.

New ways of doing business

28.170 As we noted in 1996, Program Review identified the Animal and Plant Health program as an area where the use of government resources could be reduced. The Agency developed a plan that would use a combination of cost recovery, cost avoidance and cost reduction as a means to adjust to declining resources. Based on this plan, we recommended that the Department determine the level of private good for each service provided. We also recommended that it develop a strategy to recover an appropriate amount of revenue relating to the private benefit portion of the services.

28.171 Prior to the consultations on user fees, the Agency determined a simple range of possible allocations of private and public good. The Agency informed us that during the first two rounds of consultations on user fees, actual user fees were set to respond to industry concerns about competitiveness and the cumulative impact of fees. In 1996, the Department projected that after the third round of consultations on user fees, the overall cost recovery rate would be 20 percent for the Animal and Plant Health program. At the end of the second round, the overall cost recovery rate is estimated to be 13.5 percent. The third round of consultations has been deferred as a result of a moratorium placed by the government on new user fees. As a consequence, it is not clear if the Agency's target will be met.

28.172 As noted previously, the Agency has undertaken several initiatives to assist in the identification of opportunities for efficiency and effectiveness. These initiatives, including the Agency–Wide Risk–Based Resourcing Project, the Integrated Inspection System, alternative service delivery (ASD) mechanisms and the establishment of a new Business Initiatives Centre, generally focus on cost recovery, cost avoidance and cost reduction. We encourage the Agency to continue to undertake initiatives that examine significant aspects of its operations in order to identify additional opportunities for efficiencies and effectiveness.

28.173 Our 1996 chapter recognized that as new ways of doing business were identified, the role of the Agency might change. It suggested that appropriate systems and practices to approve and then monitor and control activities would become increasingly important. The use of ASD mechanisms, although they are limited in number, has shifted the Agency’s responsibilities to standard setting, compliance, monitoring and audit. In this role, the Agency uses control mechanisms throughout the accreditation process, from the application and approval stage through to monitoring and enforcement. The principles guiding some of these control mechanisms are based on International Standards Organization (ISO) guidelines. Penalties, such as loss of accreditation or licence, are also in place for non–compliance. The development of ASD mechanisms and the related assessment of them are relatively new and the potential success of the compliance, monitoring and audit program is not yet known.

Revenue Canada — Combatting Income Tax Avoidance — 1996, Chapter 11

Assistant Auditor General: Shahid Minto

Principal: Barry Elkin

Background

28.174 In our 1996 audit of Revenue Canada's tax avoidance program, we made a number of observations and recommendations about the consultations between Revenue Canada and the Department of Finance, the detection of abusive tax-avoidance schemes, the dissemination of information about the application of the General Anti-Avoidance Rule, the use of fairness provisions in tax settlements and the use of tax shelters.

Scope

28.175 Our follow-up consisted of reviewing status reports prepared by Revenue Canada on the progress it has made on our recommendations. We also reviewed the supporting documentation prepared by Revenue Canada and had discussions with its officials in Ottawa and in the field offices of Toronto-Centre and Toronto-West.

Conclusion

28.176 Revenue Canada has taken action in all areas addressed in our 1996 chapter. It has implemented certain recommendations and has revised relevant administrative policies and practices. Field implementation of the revised policies is progressing slowly.

Observations

Strengthening the legislation

28.177 **Revenue Canada has recommended a penalty for aggressive promoters of tax shelters.** In 1996, we reported on the importance of making legislative changes as soon as possible after tax avoidance schemes are detected. We note that several legislative changes have been introduced in the last few years to curb the proliferation of abusive tax shelters.

28.178 One aspect raised in our 1996 audit was that Canadian law does not contain a penalty for promoting an abusive tax shelter. Revenue Canada has recommended promoter-penalty legislation to the Department of Finance. The matter was referred to the Minister of Finance's Technical Committee on Business Taxation (Mintz Committee), which supported the need for this penalty in its report released in April 1998. The Department of Finance has not responded yet to this report.

Improving tax administration operations and practices

28.179 **Revenue Canada has not decided whether to deny at-source-deduction hardship waivers for tax shelter losses.** In 1996, we noted that many taxpayers had requested a reduction in their source deductions on the grounds that tax shelter losses would reduce their income tax otherwise payable. Revenue Canada examined its

policy regarding at-source-deduction hardship waivers for tax shelters. As a result, the Department extended its review to all cases that are subject to the policy. The review has not been completed yet and a decision is not expected until the end of 1998.

28.180 The Tax Avoidance and the Large Business Audit units are working together in planning large business audits. In 1996 we were concerned that the review of tax avoidance issues involving large businesses was not dealt with consistently in all Tax Services Offices. In April 1998, the Department issued a directive that requires that tax avoidance auditors participate in the planning of large business audits in order to obtain assurance that potential tax avoidance issues are adequately reviewed. Subject to staffing problems in some Tax Services Offices, this directive has been adopted in the field.

28.181 Feedback from appeals sections is infrequent. The appeals process can act as a means of audit quality control, particularly when it results in significant changes to reassessments made by tax avoidance auditors. Although the Department's Appeals Renewal Initiative supports better communications between appeals officers and tax auditors, we noted that the Department had not developed a formalized approach to provide feedback to affected auditors. In the Tax Services Offices we visited, tax avoidance auditors did not routinely receive feedback from appeals officers. The Department has indicated that the existing feedback process will be strengthened before the end of the current fiscal year.

28.182 Information on the application of the General Anti-Avoidance Rule (GAAR) has been improved. In 1996, we reported that tax avoidance auditors did not receive full and relevant information on the decisions of the interdepartmental committee responsible for the review and application of the General Anti-Avoidance Rule (GAAR). This was particularly important because the courts had not yet spoken on the application of the rule.

28.183 The Department now regularly distributes a summary of the decisions of the GAAR committee to its field tax avoidance auditors. In addition, the Department has provided training and technical information sessions to over 1,500 participants in the last two years. We note that the Tax Court of Canada has rendered two decisions involving the application of GAAR since 1996.

28.184 Some progress has been made in tracking requests to cancel or waive interest and penalties. Many settlements are accompanied or followed by a request from the taxpayer to have all or a portion of applicable interest and penalties waived or cancelled. Revenue Canada is in the process of making system enhancements to track and report interest and penalties waived at the assessment stage. The Department has indicated that reporting of the amounts waived will begin in 1999-2000.

Veterans Affairs Canada — Health Care — 1996, Chapter 12

Assistant Auditor General: Don Young

Principal: John O'Brien

Background

28.185 Our audit reported in May 1996 focussed on the provision of health care by Veterans Affairs Canada to veterans and other eligible recipients. We found that the Department did not have adequate projections of the number of future potential clients or of their anticipated health care needs in order to ensure that it would have the appropriate human, physical and financial resources to address those needs. As a result, the Department did not have comprehensive plans to meet the future health care needs of its clients.

28.186 The audit noted that the Department was paying health care benefits that it considered the responsibility of provincial governments. Other than this issue, we concluded that the Department had satisfactory controls for eligibility for health care benefits.

28.187 We found that the Department had weak controls for the \$172 million expended in 1994-95 (\$161 million in 1997-98) to provide long-term care. In particular, we noted that guidelines for the expected quality of care were not in place. Cost control was deficient because of weak operating agreements with facilities, budgets were received long after the fiscal year began and there were backlogs in conducting operating reviews.

28.188 We observed weaknesses in the financial controls and health care needs assessments for the Veterans Independence Program (VIP). The Program spent \$162 million in 1994-95 (\$150 million in 1997-98) to help recipients live independently and maintain or improve health status. We also found that the Department did not have adequate empirical evidence to demonstrate the success of the Program.

28.189 We reported that there were opportunities for the Department to save money and improve quality of care in the delivery of its \$173 million (\$189 million in 1997-98) treatment and drug program.

Scope

28.190 Our 1998 follow-up work consisted of a review of documents supplied by the Department to demonstrate progress in responding to our observations. We also interviewed departmental officials to discuss and clarify actions taken.

Conclusion

28.191 The areas of concern that we raised in 1996 can be categorized as resolving responsibility for provision of health care benefits to veterans, improving long-term planning, improving the management of long-term care, strengthening financial controls and health care assessments for the Veterans Independence Program, and increasing the cost effectiveness of the treatment and drug program.

28.192 Our follow-up found that the Department has begun implementing improvements in the treatment and drug program and in its long-term planning. During 1998-99, the Department plans to implement changes in the management of long-term care and in the assessment of the health needs and status of recipients of VIP benefits.

The Department continues to pay for certain health care benefits that its legislation states are a provincial responsibility. Financial controls for the Veterans Independence Program have not improved.

28.193 Although many initiatives to improve the management of health care are currently under way, improved results cannot yet be observed.

Observations

Information on future client needs and demographics has been collected and assessed

28.194 Since our 1996 audit, Veterans Affairs Canada has conducted a number of studies to assess the needs of the aging veteran population. These studies were done as part of a major review of the health care needs of its clients. They have identified significant changes that can be expected in the health care needs of a population that is approaching an average age of 80 years. The Department has also conducted additional studies that forecast the demographic characteristics of its potential clientele up to the year 2007.

The Department still requires an approved strategy and plan to meet the health care needs of its clients

28.195 As a result of its Review of Veterans' Care Needs, the Department now has the information necessary to develop a strategy and plan to meet the future needs of its clients. Although it has developed proposed changes to programs and services, there is not yet an approved plan or strategy to implement these changes. The Department plans to have a strategy in place by 31 December 1998.

The Department continues to pay for benefits that its legislation indicates are a provincial responsibility

28.196 Departmental officials have informed us that they are not aware of any further actions by provincial governments, since our audit, to exclude veterans from certain provincial health care benefits available to other provincial residents. However, the Department continues to pay for certain health care benefits that are a provincial responsibility under Veterans Affairs legislation. The Department has limited authority to deal with broad federal-provincial issues but has indicated that it continues to be attentive to opportunities to address this matter with provinces.

Limited progress has been made in implementing improvements in the management of long-term care

28.197 Our 1996 audit raised a number of concerns about the management of contracted long-term care, including the weaknesses of the agreements with the facilities that provide such care, delays in obtaining and approving the budgets of these facilities, the monitoring of financial performance and quality of care, and limited long-term planning for priority access beds in the future. During our follow-up, we found that the Department was still in the process of developing approaches to resolve these concerns.

28.198 There is little that the Department can do to renegotiate weak transfer agreements that in some cases are over 30 years old. However, the Department has developed a policy that requires at least annual contact with clients in facilities. This contact is to be supported by a structured questionnaire to elicit information on the quality of care provided to the veterans. If concerns are identified, each case is to be referred to a departmental health care professional for in-depth follow-up. If a problem is confirmed, the intention is to resolve the issue with the institution or the relevant provincial health authorities. This procedure was planned to begin in September 1998.

28.199 Beginning in 1999, the Department intends to establish a target of receiving operating budgets for facilities within six weeks of the start of the fiscal year. In one region, financial reviews are still not conducted on a timely basis. In order to improve the timeliness of financial reviews, the Department has indicated that it will soon obtain supplemental contracted auditing services to aid existing staff. However, the contract for these services is not yet in place.

28.200 The Department's review of health care needs has identified the expected needs of veterans and developed proposals to deal with these needs in the future. As a result of this study, the Department does not believe that there will be a requirement for an increased number of priority access beds, although the distribution of existing beds may have to change. The Department is currently examining housing and social support options as alternatives to adding new hospital beds.

The Department is strengthening its assessment of the health care needs of recipients of VIP benefits

28.201 In our 1996 audit, we noted that there was a weak link between the VIP benefits provided to recipients and the needs of the recipients. Since then, the Department has developed an approach to managing VIP recipients based on an assessment of health care risks. All clients are to be contacted at least annually to determine if health care status has changed. Counsellors are to focus on the needs of clients identified as having a higher risk of health problems. The information gathered during this process should be useful in assessing the impact of the Veterans Independence Program on recipients' health. The Department planned to begin systematically collecting and reporting this information in 1998. As indicated in the approved audit and evaluation plan, the Department intends to conduct an overall study of the impact of the Program.

Financial controls for the Veterans Independence Program have not improved

28.202 Under the terms of the Program, recipients of VIP benefits are to keep receipts to show that funds were spent to acquire the services intended. In our 1996 audit, we found that there were poor controls in place to ensure that those who received their payments in advance maintained receipts. The Department's post-payment verification process found that in many cases receipts were not maintained. The Department is exploring options for the delivery of VIP services to clients. These options include moving away from estimated costs to a predetermined amount for each type of service, or establishing operating agreements with registered service providers who could bill the Department directly. However, because of other health care initiatives that are under way, the Department has not taken steps to implement these changes.

Management of the treatment and drug program has significantly improved

28.203 In 1996, we noted that the Veterans Affairs treatment and drug program paid for many more drugs, products and treatments than other similar Canadian programs. We also noted that the Department did not have a system to effectively monitor and control the cost and quality of these services.

28.204 Since 1996, the Department has revised its drug formulary into three categories. The first category of about 6,000 products represents a standard formulary of generally accepted drugs and products. The second category of 1,200 items represents newer, more expensive products. A special authorization unit has been established to authorize the dispensing of these products. The third category includes products that require a client's physician to justify why they are medically effective. For over-the-counter medication, the revised formulary also includes "reasonable use" annual and quarterly dollar limits for specific drugs and products and cumulative limits for all over-the-counter products.

28.205 To support these changes, the Department has developed a point-of-sale system that is connected to pharmacies throughout Canada. This system was implemented in the Pacific Region in May 1998 and is planned for

full implementation by February 1999. The system informs the pharmacist if the Department will pay for an item or if further authorization is required. In addition, the system will inform the pharmacist if the client has a prescription with another pharmacy that may be in conflict with the prescription being filled.

The Department has made limited progress in reducing the cost of providing over-the-counter drugs

28.206 As part of its review of the drug program, the Department retained in its formulary only over-the-counter medications that had a recognized therapeutic effect. About 2,500 of the 6,000 drugs in the standard formulary are over-the-counter medications. The Department is continuing to negotiate with other provincial authorities to eliminate the dispensing fee for over-the-counter products. The dollar limits discussed in paragraph 28.204 for over-the-counter products should also contribute to cost control over these medications. Departmental officials have informed us that this decision was made in order to maintain control over the use of these products by requiring a prescription, and because many of these products are lower-cost alternatives to prescription medication. Therefore, without renegotiating agreements with the pharmacy associations, the Department will continue to pay a dispensing fee for these products. Veterans Affairs is only one of several federal departments that pays for the cost of treatment and drugs provided to clients. However, the Department has negotiated arrangements with two provincial pharmacy associations to pay a standard markup rather than a dispensing fee.

Revenue Canada and Department of Finance — Excise Duties and Taxes on Selected Commodities — 1996, Chapter 18

Assistant Auditor General: Shahid Minto
Principal: James Ralston

Background

28.207 Our September 1996 audit assessed whether Revenue Canada used appropriate and sufficient controls, systems, practices and information to ensure that excise taxes and duties on selected commodities were correctly assessed, collected and reported. We also examined the procedures of the Tax Policy Branch of the Department of Finance to determine whether it monitored and evaluated the tax measures adequately. There are two broad areas of risk to revenue: evasion through smuggling, illegal or unlicensed production, diversion and other means; and failure by licensed producers to pay the right amount of excise duties and taxes.

28.208 We noted that Revenue Canada had strengthened enforcement activities to address evasion and was participating in the government's anti-smuggling initiative that was particularly relevant to combatting evasion of selected commodity taxes. However, this initiative was scheduled to end on 31 March 1997 and we said that continued enhanced, co-ordinated enforcement activities were needed to address the serious and persistent problem of evasion. But we noted that enforcement alone would not eliminate evasion; it was important to regularly analyze the inherent nature and underlying causes of evasion to provide decision makers with current information to develop policies that would address the problem.

28.209 We were concerned that the excise audit strategy and coverage were not adequate. We recommended that Revenue Canada monitor its physical surveillance of excise duty licensees to determine whether the surveillance program was consistent with the plan to reduce the on-site presence of excise duty officers. Our 1996 audit determined that no excise tax audits had been done on most large licensees in the previous five years, because audit activities had been concentrated on GST accounts that were rated higher in potential for revenue recovery. Because excise tax audits are statute-barred after four years, we were concerned that the Department risked failing to collect significant amounts of revenue. We also recommended that risk analyses be used to select licensees for audit, that audit programs be updated and standardized and that staffing and training needs be addressed.

28.210 We noted that Revenue Canada lacked relevant information and indicators for assessing compliance with the selected commodity tax measures, for monitoring its performance in administering the excise duties and taxes, for allocating resources, for providing accountability and for assisting Finance in its monitoring and policy review. We recommended that it develop appropriate indicators. We also recommended that, given potentially serious fuel tax evasion, Finance consider the need for a review of the fuel excise taxes, similar to the 1993 reviews of the tobacco tax and the jewellery tax.

28.211 Finance, Revenue Canada and affected industries were concerned that many provisions of the *Excise Act* were outmoded and in need of reform. Although there was agreement on the need for a review of the *Excise Act*, Revenue Canada and Finance officials advised that, because of other priorities, the review begun in 1993 was still in progress. We recommended that completion of this review be completed on an urgent basis because needed changes and desired improvements in administration were being held up by its protracted review.

Scope

28.212 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada and the Department of Finance in June and July 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation and conducted interviews with departmental officials to discuss actions taken.

Conclusion

28.213 Revenue Canada has taken steps to address most of our audit concerns. The Assistant Deputy Ministers' (ADM) Anti-Evasion Committee has been formed to provide a forum for integrating strategies aimed at anti-evasion. Other committees are undertaking to analyze the size and causes of evasion problems related to alcohol and fuels. The audit strategy and programs for excise duties have been reviewed and redefined to focus on risk areas. Further effort is required to ensure adequate audit coverage of excise tax licensees. Because evasion of excise taxes is a persistent and serious problem, continuing, sustained efforts are needed.

28.214 The Tax Policy Branch of the Department of Finance continues to monitor indicators of potential excise tax evasion problems and advises that there is no evidence of a need for a fundamental review of fuel excise taxes. In 1996, we were concerned that quicker action was needed on the review of the *Excise Act*. Proposed legislative amendments to the Act are expected soon, taking into consideration consultations with industry associations and members as well as provincial governments.

Observations

Activities to combat evasion

28.215 The three-year anti-smuggling initiative was announced in 1994 to deal with the serious problem of tobacco smuggling. In 1997, the continuation of the initiative was approved, although at lower funding levels. The existing funding of \$27.4 million for Revenue Canada was approved for one additional year (1997-98); thereafter it will be reduced to 85 percent for 1998-99 and to 65 percent for 1999-2000 and beyond. The Department has put in place an Anti-Smuggling Initiative Evaluation Management Working Group to evaluate the impact of this initiative and address funding requirements. Other anti-evasion initiatives such as the Tobacco Export Verification Program, the Alcohol Control Measures Program and the Fuel Tax Administration Project are also continuing.

28.216 Because the various initiatives and ongoing enforcement activities are interconnected, we recommended in 1996 that a focal point be established to minimize duplication, resolve differences in priorities and promote efficiency and effectiveness. The ADMs' Anti-Evasion Committee has now been in operation for over a year. The ADMs' Committee determines the significant evasion problems and looks at overall compliance efforts.

28.217 The Anti-Evasion Division was recently created to consolidate and share information on anti-evasion activities across directorates and regions and to support the ADMs' Anti-Evasion Committee. Although the Division is not yet fully staffed, it is undertaking to co-ordinate the sharing of information about anti-evasion initiatives across regions and directorates in order to avoid duplication and to benefit from lessons learned.

Assessment of the evasion problem

28.218 Our 1996 audit recommended that regular and comprehensive assessments of the extent and causes of evasion be done so that problems at the policy and administrative levels could be appropriately addressed. Since October 1996, Revenue Canada has represented Canada on the Canadian Fuel Tax Uniformity Project, which

includes provincial and industry representatives. Its mandate has two main thrusts — harmonization of fuel tax administration and reducing evasion through audit and enforcement. Another departmental initiative under way is a Fuel Tax Study to assess the presence, extent and nature of fuel tax evasion across Canada and the relevant American states.

28.219 We had recommended in 1996 that the Tax Policy Branch of the Department of Finance consider the need for a review of fuel excise taxes. The Department advises that there is no evidence of a need for a fundamental review of fuel excise taxes. Finance does consider particular aspects of fuel excise tax policy where there are indications of potential problems.

28.220 At Revenue Canada, an Intra-Departmental Committee on Alcohol Enforcement and Tax Evasion has just been set up. This committee will provide co-ordination to ensure that the illicit alcohol problem is approached from a department-wide national view. Its activities will include determining the size of the problem and ensuring that gaps that allow evasion are detected and closed.

28.221 The Tax Policy Branch of the Department of Finance continues to monitor various sources of data and to consult with the provinces and other government departments in order to assess the impact of tax policy and legislation on the potential for evasion. Three modest increases in tobacco taxes since 1994 are a direct result of these collaborative efforts and are designed to restore tax revenues with minimal risk of renewed contraband activity.

Excise audit strategy and audit coverage

28.222 Excise duty is imposed on beer, spirits and tobacco at the point of manufacture. Because these commodities are susceptible to diversion, Revenue Canada conducts on-site surveillance as well as periodic audits. The Department has completed an assessment of its surveillance programs and determined that it has the appropriate balance between surveillance and audits. Excise duty audit programs have also been reviewed and amendments made to remove sections no longer relevant and to improve the sections where potential for revenue loss was identified.

28.223 Excise taxes are imposed on tobacco products, motive fuels, wine, jewellery, automobile air conditioners and certain automobiles at the time of delivery to the purchaser. Excise tax audits are conducted under the umbrella of the GST audit program. Headquarters provides functional guidance to the regions on audit strategy and allocation of resources. In response to our 1996 audit, Revenue Canada stated that large licensees would be audited every second year. The remaining 2,100 small excise tax licensees are to be subject to a two percent audit coverage. In 1997-98, 103 excise taxes audits were carried out, of which three were audits of large entities. It appears that the target coverage of the 32 large licensees is not yet being achieved, since only about 10 percent were audited in 1997-98. Beginning in October 1998, a compliance review program will be available to auditors to assess whether there are any potential excise tax non-compliance issues during the course of an income tax or GST audit of small enterprises.

28.224 Our 1996 audit noted that the number of auditors with excise tax audit experience and good knowledge of particular industries had declined. Auditors had no formal training in excise duty and taxes or in business practices and computer skills essential to today's audit environment. The Department has developed a self-study course on the basics of excise tax legislation and a more in-depth, instructor-led course is to be made available in the fall of 1998. The excise duty brewery, distillery and enforcement courses have also been rewritten and delivered on a number of occasions.

Monitoring compliance and performance

28.225 We recommended in 1996 that Revenue Canada, in collaboration with the Department of Finance, develop appropriate indicators and analytical data for monitoring compliance and performance, for supporting decision making and for providing accountability. A new Excise Duty Reporting System has been developed to capture client-specific activities, such as production volumes and shipment destination. This system can be used to monitor trends and contribute to intelligence assessments of non-compliance. An Excise Duty Management System has also been put in place that will be used to develop licensee histories, establish a risk assessment framework, identify areas of non-compliance, maintain a casework database and provide workload and budget analysis.

The *Excise Act* review is progressing

28.226 In 1993, Revenue Canada and Finance began a comprehensive review of the *Excise Act*. The objective was to propose legislation that would provide a fair and modern tax structure, minimize the compliance burden on affected industries and safeguard significant revenue from taxes on alcohol and tobacco products. At the time of our 1996 audit, this review was still in progress but was expected to be completed that year, with draft legislation to be tabled in early 1997. In February 1997, the Ministers of Finance and National Revenue released a discussion paper outlining proposed changes to the structure of taxation of alcohol and tobacco products. A document outlining proposed legislative amendments was being drafted at the time of our follow-up, taking into consideration submissions from and consultations with industry associations and members as well as provincial governments.

Revenue Canada — Creating One Revenue Canada: The Administrative Consolidation of Customs and Excise and Taxation — 1996, Chapter 20

Assistant Auditor General: Shahid Minto

Principal: James Ralston

Background

28.227 Our 1996 audit looked at whether the process followed in the administrative consolidation of Customs and Excise with Taxation was appropriate and adequately managed and whether the results of some of the significant initiatives demonstrated that stated objectives were being achieved. The audit focussed on three major aspects:

- Revenue Canada's steering of the whole consolidation process at the corporate level;
- introduction of a single business number, which facilitated the consolidation of its registration and information resources; and
- the opening of business window service sites, which entailed the consolidation of human resources from different work cultures.

28.228 Our audit found that senior management had articulated an overall vision of what Revenue Canada would look like with the two departments combined into one. The vision had sufficient detail to guide planning and implementation. Those working on various implementation projects developed the details to attain the vision. Keeping staff informed and maintaining communication with clients were among the guiding principles for consolidation.

28.229 The business number is a unique business identifier that replaced the multiple numbers that Canadian businesses previously had to have to deal with the federal government. It eliminated the need to register separately for payroll deductions, goods and services tax, corporate tax and import/export duties. Our audit noted that Revenue Canada did a very good job of developing the business number and acknowledged this as a significant accomplishment. We noted that the business number had the potential to improve Revenue Canada's service and enforcement capabilities, but at that point we could only say that the Department was off to a good start. We noted that there was a risk of an overload of work after the 31 December 1996 deadline for conversion, because 60 percent of companies had not yet converted as of 30 April 1996.

28.230 The business window approach allows businesses to access information about Revenue Canada's main business lines through one point of contact. By October 1995, the Department had introduced business windows in 48 offices across Canada, which handled an estimated 3.8 million enquiries per year, mostly telephone enquiries. We noted that the business window had improved access to counter services and should reduce the cost of compliance for most businesses. We found that improvements in telephone service at the business window were still required. Service is measured in terms of the likelihood of a call being answered, the wait times and the accuracy of the information provided. Many staff felt they needed more training to be able to respond confidently to enquiries. Also, the job descriptions and classification of business window staff needed to be reviewed.

28.231 Throughout the implementation of the business window approach, employee communication and involvement were generally good and stakeholders were adequately informed and involved. In spite of the Department's efforts to deal with the cultural differences of the organizations being merged, many GST staff

expressed a “feeling” of being taken over by the larger Taxation group. Dress codes, rules of conduct and hours of work changed and the new organization adopted the Taxation time reporting and production measurement systems.

Scope

28.232 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada in July and August 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation provided to us by the Department.

Conclusion

28.233 The envisioned benefits of the administrative consolidation of Customs and Excise with Taxation are being achieved. Resources dedicated to administration and information technology have been reduced. The consolidation of programs such as dispute resolution and redress, and the introduction of the business number system and the business window approach have resulted in greater efficiencies and improved client service.

Observations

Consolidation goals being achieved

28.234 The objectives of administrative consolidation included developing a more effective, consistent and harmonized approach to the delivery of the Department’s legislative mandate, enhancing client service and creating opportunities for efficiency gains. These objectives are being realized. For example, the dispute resolution processes for income tax, Canada Pension Plan and Employment Insurance, GST, excise, customs adjudications and trade administration have been consolidated and single window access to the redress process has been made available. As a result, clients can deal with one contact point for different issues. Harmonized policies and procedures and enhanced information sharing help ensure the consistent application of relevant legislation.

28.235 The number of full-time equivalents dedicated to administration and information technology has declined, attributable at least in part to administrative consolidation. The consolidation also provides departmental employees with more career paths and development opportunities. The management framework that was put in place, including the Strategic Plan and Corporate Accountability Framework, is being updated in preparation for the move toward a new Canada Customs and Revenue Agency.

Business number conversion completed successfully

28.236 All business clients have now been converted to the new business number system. The expected benefits of the business number system are also being realized. Because the business number provides access to a common body of information, auditors and administrators are more aware of cross-program relationships. This has helped to identify new issues of non-compliance, to more accurately estimate revenues at risk and to prioritize and target enforcement efforts. Revenue Canada also has a number of initiatives with several provinces to use the business number to develop a broader range of integrated services.

28.237 Our 1996 audit noted that because of severe time pressures, the testing of the business number system was late and fragmented and that both the former departments lacked a formal quality assurance and control function. An internal task force completed a review of the Department’s systems quality assurance process and its recommendations for a single consolidated production assurance model are being implemented.

Improvements to business window service

28.238 Improvements in telephone service at the business window are being made. Revenue Canada has implemented an automated voice response system for the business window in the Ottawa, Quebec, Calgary and Vancouver Tax Services Offices. A detailed evaluation of the operation of this system was to be conducted in the fall of 1998 to determine whether it should be expanded to other offices.

28.239 Training profiles have been developed to identify what knowledge and skills business service agents need to answer enquiries accurately and effectively. These profiles will be used to determine what training to give and to integrate training with on-the-job experience. The Business Window On-Line Information System was developed in 1997 to assist agents to answer questions on all programs quickly and accurately.

28.240 Our audit noted that, as a result of the introduction of the business window approach, officers who were classified at different levels were doing equivalent duties. The job descriptions have been reviewed and a revised job description for more senior business service agents was implemented in February 1998.

28.241 The Department has established national service standards for counter service wait time, telephone accuracy and accessibility. Standards for counter wait time are generally being met. Data on telephone accuracy and accessibility have been compiled and are being analyzed. Findings and recommendations for appropriate action will be reported to senior management.

Federal Contaminated Sites — Management Information on Environmental Costs and Liabilities — 1996, Chapter 22

*Commissioner of the Environment and Sustainable Development: Brian Emmett
Principals: Wayne Cluskey and Dan Rubenstein*

Background

28.242 Focus on central leadership. Our November 1996 chapter reported on the progress made by the government in developing management information on the environmental risks, costs and liabilities posed by contaminated sites on federal land. The focus of our work was on the federal government's overall management approach toward gathering information on its portfolio of thousands of contaminated sites. Work was also done at three departments with large portfolios of federal land — National Defence, Transport Canada and Indian and Northern Affairs Canada.

28.243 Lack of a complete picture. Our overall conclusion in 1996 was that the federal government did not have a complete picture of its environmental risks, costs and liabilities arising from federal contaminated sites. Nor did it have a timetable to assemble a complete picture. We reported limited central leadership and a lack of accountability for providing this leadership. We concluded that the government was not in a position to adequately assess the risk to health, safety and the environment and to establish the timing and costs for remediation of federal contaminated sites.

Scope

28.244 Focus on progress reports. The starting point of our follow-up work was evidence presented at the Standing Committee on Environment and Sustainable Development on 17 February 1998 by Environment Canada, the Treasury Board Secretariat and Public Works and Government Services Canada. We then asked Environment Canada, the Treasury Board Secretariat and the interdepartmental Contaminated Sites Management Working Group for a status report of their progress, as at 30 May 1998, in implementing the recommendations in Chapter 22 of our 1996 Report. We conducted a number of interviews and reviews of supporting documentation related to these progress reports. We did not do any detailed work at individual departments.

Conclusion

28.245 Important central leadership issues still remain unresolved. While limited progress has been made in specialized areas, the federal government, the largest landholder in Canada, still does not have a comprehensive view of the potential risks to health, safety and the environment associated with its more than 5,000 contaminated federal sites identified at the time of our November 1996 chapter. Nor does it yet have a complete and accurate view of the related contingent or actual liabilities. Two years after our initial report to Parliament, the government has not developed and implemented a central timetable, and has not finalized and implemented a high-level environmental policy or common standards for due diligence in a consistent manner. It remains unclear whether Environment Canada or the Treasury Board Secretariat is to be accountable for providing the required central leadership. As a result, the government is still unable to assure Parliament and the people of Canada that it is aware of the potential risks to health, safety and the environment, and that it has a comprehensive plan to manage these risks.

Treasury Board Secretariat's response: The management of contaminated federal sites ultimately resides with those departments that have custody of real property. We are, however, committed to the effective government-wide

management of all aspects of real property, including contaminated sites. The Treasury Board Secretariat is committed to ensuring that the issue receives the attention required and is therefore increasing its level of activity. With respect to the observations on the reporting of costs and liabilities, the Secretariat has redrafted its proposed accounting policy taking into consideration comments received from departments. The revised policy will be issued this year and we expect to be in a position to report liabilities, as defined in our draft accounting policy, as at 31 March 1999.

Observations

Lack of central leadership and clear accountability

28.246 No one organization has overall accountability. No one organization has been assigned the responsibility of ensuring that progress is made against an established timetable for the identification, assessment and ultimate remediation of the portfolio of federal contaminated sites. The government has emphasized that each federal department is responsible for its own clean-up.

A central timetable needs to be established

28.247 Lack of consensus on a central timetable. The government continues to disagree with our Office over the need for a government-wide action plan and timetable to complete the identification, assessment and remediation of all federal contaminated sites, particularly its high-risk sites.

28.248 Most other organizations we reviewed with a large portfolio of lands take a “portfolio-wide” approach to identifying their highest-risk sites and dealing with them first. However, the federal government continues to take a fragmented approach that raises questions about whether the approach is the right one. Progress is related to each department’s level of interest in dealing with its own contaminated sites. This approach is causing the government problems, as discussed in the section of this follow-up dealing with better government-wide reporting of environmental costs and liabilities.

28.249 The Real Property Management Division at the Treasury Board Secretariat told us that structural or organizational changes had recently been made to better enable it to address horizontal (government-wide) issues. As indicated in its formal response to us, these changes include becoming a “management board” that can assess and respond to government-wide priorities. However, we observed that the exact nature of the role of the management board, as it specifically relates to contaminated sites, remained to be determined.

A comprehensive environmental policy is needed

28.250 Draft policy still to be approved. The Environment Accountability Partnership’s sub-committee on contaminated sites has prepared a draft policy on contaminated sites management. The policy states that contaminated sites on federal land shall be identified, classified, managed and recorded in a consistent manner. At the completion of our follow-up work, this draft policy had yet to be formally approved by the Treasury Board Secretariat and recommended for inclusion in the Real Property Management Manual. Currently, there is no fixed timetable for the approval and implementation of this draft policy. The Contaminated Sites Management Working Group has been developing a Federal Contaminated Sites Framework, which would provide the specifics necessary to support the draft policy. However, by the completion of our field work in July 1998, the Framework had not been finalized. The Working Group had also developed a discussion paper entitled A Risk Management Framework for Contaminated Sites, which was released in June 1997.

Minimum standards of due diligence need to be defined

28.251 A government-wide position not established. The Contaminated Sites Management Working Group has discussed the issue of due diligence expected of custodial departments, including minimum standards, and the Group has provided courses and training in the area. However, a definitive government policy position, including the extent to which custodial departments should meet the environmental and health standards of provincial and local jurisdictions, has yet to be established, approved and implemented.

Better reporting of costs and liabilities

28.252 Significant work is needed to develop a consolidated estimate. The Treasury Board Secretariat's Government Accounting Policy Division has developed and circulated to departments a draft accounting policy that defines environmental liabilities related to federal contaminated sites. Departments were asked to provide their comments to the policy by 20 March 1998. The plan was that the policy was to be amended by 30 April 1998, based on comments received. Departments would then be asked to report their inventories of contaminated sites and remediation costs to the Secretariat by 30 September 1998, based on the amended policy. The Treasury Board Secretariat, together with Receiver General staff, would then develop detailed instructions for departmental reporting of environmental costs and liabilities as at 31 March 1999, based on the more detailed departmental comments. As at 31 August 1998, the policy had not yet been amended and circulated to departments.

28.253 Major implementation problems. The comments received on the draft accounting policy from 10 departments managing contaminated sites were fairly consistent. Three departments stated that they would not be able to meet the Treasury Board Secretariat's deadline. One mentioned that it needed a four- to five-year time frame to properly identify, assess and cost the remediation of its contaminated sites. Four departments stated that they needed more guidance *now* with regard to the nature and extent of the required reporting data before setting up systems to implement the policy. The source of funds to identify, assess and cost the remediation for all sites, as required by the draft accounting policy, was another major concern.

28.254 The preparers of the government's consolidated estimate of federal environmental costs and liabilities continue to be hampered by the lack of central time frames for departments to identify, assess, cost and remediate their contaminated sites. Based on our review of the responses to the Treasury Board Secretariat on the draft accounting policy, it became clear that the Secretariat faces a real problem with implementing the policy by 31 March 1999. We anticipate that some departments will have less difficulty providing the Treasury Board Secretariat with the required data by the targeted date, assuming more guidance is provided. However, other departments reported that they are still at the initial stages of identifying their sites, with only limited funding available to accelerate the pace of their work.

The unresolved governance dilemma

28.255 Capacity to manage horizontal issues is needed. From our perspective, the government faces an unresolved governance dilemma. How will it ensure the readiness of individual departments to comply with the draft accounting policy, given its fragmented approach to the management of its thousands of contaminated sites? How can it ensure that parliamentarians and Canadians will know the extent of the risk to health, safety and the environment, and the costs of mitigating the potential risks, without a common timetable for the identification and assessment of all federal contaminated sites? These questions will need to be addressed to ensure informed and effective management of contaminated sites.

Materiel Management in the Federal Government — 1996,

Chapter 23

Assistant Auditor General: Shahid Minto
Director: Gary Barber

Background

28.256 Since 1980, we have on several occasions identified significant deficiencies in materiel management in the federal government. Our 1996 audit of materiel management confirmed that many deficiencies still existed at that time. Our observations were based on an examination at the Treasury Board Secretariat, Department of National Defence, Natural Resources Canada, Royal Canadian Mounted Police (RCMP), and Fisheries and Oceans.

28.257 We also observed that many initiatives were under way to address the deficiencies. There was a potential to achieve savings of hundreds of millions of dollars. We encouraged the government to develop an effective accountability framework for materiel management.

28.258 On 11 and 12 February 1997, the Standing Committee on Public Accounts held hearings on the results of our audit and a report was issued on 15 April 1997. This report contained several recommendations to the government for improving performance. The Committee stressed the need to clarify the respective roles and responsibilities of the Treasury Board Secretariat and operating departments in the area of materiel management. A report on the status of progress was provided on the government's behalf by the Treasury Board Secretariat to the Committee on 24 April 1998.

Scope

28.259 This follow-up is largely based on discussions with departmental and Treasury Board Secretariat officials on progress since 1996, assertions they have made in this regard and a review of supporting documentation.

Conclusion

28.260 Although it is too early to determine all the results of the initiatives under way, we are satisfied with the attention given by departments, since the 1996 audit, to improving materiel management. There has been a great deal of progress in achieving savings by closing and consolidating warehouse space, and reductions in inventory levels across government exceed \$480 million. In addition, departments have been improving their materiel management practices and strengthening information systems.

28.261 Furthermore, the Treasury Board Secretariat and Public Works and Government Services Canada expect that the government will resolve, in 1998-99, the long-standing controversy over the mandatory use of the Crown Assets Distribution Directorate.

28.262 The Treasury Board Secretariat told us that its role and relationship with operating departments for materiel management has been further clarified. Deputy ministers of departments, not the Secretariat, are answerable for the management of materiel under their jurisdiction. The Secretariat is responsible for setting standards, providing guidance and monitoring overall performance. The extent to which the Secretariat should be involved in the

monitoring of individual departmental performance and the manner of reporting government-wide performance requires further discussion.

Treasury Board Secretariat's response: We are pleased and agree with the conclusion of the report that the government has made a great deal of progress in materiel management. We are committed to making further advances in the future through procurement reform, improved disposal mechanisms and processes, including the rationalization of warehousing, and through improved training and professional development programs for the materiel management and supply community. Additionally, the government has invested heavily in the development of information technology infrastructure, which promises to provide improved information for the management of materiel in the future.

Observations

Management information systems

28.263 In 1996, we found that departmental information systems for managing materiel were generally inadequate. Key deficiencies were the variety and incompatibility of systems and the inadequacy of cost and performance information. To make cost-effective decisions, managers needed information on all relevant costs of operations, including materiel. Progress is under way to address these issues.

28.264 Natural Resources Canada and the RCMP are in the process of implementing integrated financial and materiel management information systems. We have been informed that these systems are expected to be fully operational by 31 March 1999. In April 1997, Fisheries and Oceans implemented an integrated financial and materiel management system.

28.265 The Canadian Forces Supply System Upgrade project (CFSSU) was approved by the Treasury Board in 1985. A contract was signed in January 1995 and the end of the project was expected in January 1999. When we reported on it in November 1996, the project represented a high risk of being late, of going over budget and of not meeting National Defence requirements. Over the past two years, National Defence management and the contractor have switched from a custom-built solution to an off-the-shelf one in an effort to reduce risk. In our December 1997 Report, we reported a revised target date of September 1999. However, as of September 1998, an additional five-month delay had already been recognized and negotiations were under way to establish a new timetable for final delivery of the system. The project management team still expects to meet its overall budget of \$295 million. Although CFSSU remains a high-risk project, we are encouraged by management's efforts to contain both costs and delays while meeting the core requirements for the system.

Inventory and warehouse management

28.266 Too much inventory was being held. Government officials whom we interviewed at the beginning of our 1996 audit said they believed that their organizations had too much inventory. Departments were holding excessive quantities of items that had to be stocked in government warehouses, and also were stocking items that were commercially available and did not have to be stocked. Our 1996 audit found that the magnitude of the overstocking varied with the organization. All of the organizations we examined had initiatives under way to address the problem of holding excess inventory. Since then, reductions of \$483 million in the inventories held by departments are being reported. See Exhibit 28.3.

Exhibit 28.3

Reduction in Inventories Held by Departments from 1996-1998

(\$ millions)

Department	1996	1998	Reduction
National Defence	\$6,925.0	\$6,477.0	\$448.0
Fisheries and Oceans	\$123.0	\$96.0	\$27.0
RCMP	\$11.7	\$8.4	\$3.3
Natural Resources Canada	\$14.4	\$9.9	\$4.5
Total (approx.)	\$7,074	\$6,591	\$483

Source: Departments (not audited)

28.267 National Defence informed us that it will complete its review of the approximately 850,000 line items in its inventory holdings by March 2000. Approximately 200,000 line items have been reviewed and a further 200,000 are currently under review. This review has resulted in a reduction of approximately 15 percent of inventory volume (57,000 cubic metres), with the target being a 30 percent reduction (113,000 cubic metres) by March 2000. Of the Department's total inventory of \$8.5 billion in 1996, \$6.9 billion was centrally managed in depots and warehouses. Since 1996, the Department reports a reduction of about \$448 million in the centrally managed inventory — from \$6.925 billion to \$6.477 billion.

28.268 Fisheries and Oceans has reviewed its materiel holdings. It reports that these holdings have been reduced by 22 percent, from \$123 million to \$96 million and that the total warehouse and storage space has been reduced by 21 percent, from 173,000 square metres to 136,000 square metres. In May 1998, the Department received the Materiel Management Institute's Materiel Management Recognition Award for its achievements with the Inventory Review Project.

28.269 The RCMP reports that it has reviewed its inventory holdings and reduced them by 28 percent, from \$11.7 million to \$8.4 million. Natural Resources Canada informed us that its inventory holdings have been reduced by 31 percent, from \$14.4 million to \$9.9 million.

28.270 Improvements at National Defence supply depots. In 1996 National Defence consolidated its supply depots in Edmonton, Toronto, Montreal and Moncton into two depots in Montreal and Edmonton. In Montreal, a new warehouse was built to accommodate the consolidation of the Moncton and Toronto supply depots. We reported that the Department encountered difficulties in consolidating the inventory from the Toronto and Moncton depots into the new Montreal facility. For instance, we found that the warehouse management information system did not have all the information required to make optimum storage decisions and that the materiel storage layout used by the depots was unsuitable for items requiring high turnover and fast response.

28.271 We have been informed that our concerns are being actively addressed. The new warehouse management information system is now fully operational at the Montreal depot. National Defence reports that it has reduced the number of line items held at each depot during the period 1996-98. In Montreal, the number of line items has been reduced from 400,000 to 350,000, while in Edmonton the reduction has been from 300,000 to 277,000.

28.272 Although the greatest reductions in depot size and the number of staff employed occurred prior to 1996, since 1996 National Defence has further reduced the size of its remaining two supply depots and the number of people employed. See Exhibits 28.4 and 28.5.

Exhibit 28.4

Reduction in Size of National Defence Supply Depots

(square metres)

Depot	April 1995	April 1996	April 1998	Change 1996-98
Toronto	89,000	0	0	0
Moncton	51,000	0	0	0
Montreal	162,500	162,500	153,500	9,000
Edmonton	79,000	79,000	73,500	5,500
Total Area (approx.)	381,500	241,500	227,000	14,500

Source: National Defence (not audited)

Exhibit 28.5

Reduction in Personnel at National Defence Supply Depots

Depot	April 1995	April 1996	April 1998	Change 1996-98
Toronto	245	0	0	0
Moncton	238	0	0	0
Montreal	427	427	265	162
Edmonton	255	239	125	114
Total	1,165	666	390	276

Source: National Defence (not audited)

28.273 Essential records. In 1996 we pointed to the need to improve essential records of materiel holdings in order to maintain complete and accurate inventory records.

28.274 National Defence continues to follow its policy that requires 100 percent physical verification of all materiel over a four-year cycle. During the period January 1996 to December 1997, stock was taken of over 55,000 line items. Adjustments were made where necessary. The Montreal depot implemented an ISO 9002 Quality System, with the objective of a 99 percent accuracy rate. The depot was certified in July 1998. National Defence policy requires that more frequent verifications be performed on certain items such as small arms, large weapons and classified equipment. The Department reports that a recent verification confirmed an accuracy rate of 100 percent on such items.

28.275 The RCMP has informed us that, as of June 1998, the inventory in the warehouse has been verified for accuracy and recorded in the newly implemented warehouse management information system. The RCMP is also in the process of performing a verification of all of its materiel assets and recording this information in its new integrated information system. Progress, however, has been slower than expected and the original target date of December 1997 was not met. The new target date for completion is March 1999.

28.276 Fisheries and Oceans reports that it has reviewed all of its inventory holdings and approximately 50 percent of the inventory is recorded in the new integrated information system. The remainder of the Department's inventory holdings will be recorded over the next 12 to 18 months. Fisheries and Oceans is also in the process of physical verification of its materiel assets and recording these in the integrated information system. The Department informed us that about 75 percent of its materiel assets are currently recorded and that physical verification of all these items is scheduled to be completed by December 2000.

28.277 Natural Resources Canada informed us that it will have reviewed the records of all of its materiel assets for accuracy and completeness by 31 December 1998 and that these assets will then be recorded on the new integrated information system.

Policy and management framework

28.278 Accountability framework. In 1996 we found that the essential elements of an effective accountability relationship were missing from the policy and management frameworks for materiel management in departments. We found that roles and responsibilities were unclear and little review of departmental performance was done, which prevented the measurement of performance against expectations.

28.279 Both our 1996 chapter and the subsequent hearings by the Public Accounts Committee raised questions about the appropriate role of the Treasury Board Secretariat in government-wide materiel management.

28.280 In 1997, the Independent Review Panel on Modernization of Comptrollership in the Government of Canada issued its report. The Panel recommended, among other things, that the Secretary of the Treasury Board/Comptroller General:

- establish appropriate standards (and key frameworks) for financial and non-financial information reporting and budgeting for the government as a whole;
- know the extent to which the above-noted standards are met government-wide;
- act to preserve these standards, when necessary; and
- supply government-wide financial and non-financial performance information.

28.281 The Treasury Board Secretariat's work on improving reporting to Parliament and the Panel on Modern Comptrollership have helped to clarify the Secretariat's role. The Secretariat emphasizes that deputy ministers are solely accountable for the management of materiel in their departments. The Treasury Board Secretariat informs us that it is accountable for two things: first, developing policies and guidelines on materiel management to address the needs of all departments and to address any common problems that may emerge government-wide; and second, providing high-level co-ordination and monitoring within its mandate to ensure "vigorous stewardship of resources and assets" within the government. The Secretariat pointed out to us that the latter does not include ongoing monitoring of the performance of individual departments, nor does it include synthesizing or consolidating information across departments. However, it does include participation in benchmarking materiel management performance against norms in other governments and in the private sector. It also includes providing a general overview of government-wide materiel management issues, initiatives and results in the Secretariat's own Performance Report to Parliament each year.

28.282 Fisheries and Oceans, Natural Resources Canada and the RCMP informed us that they have reviewed their policy and management framework for materiel and that the implementation of new policies is either complete or will be completed by 31 March 1999.

28.283 Although progress to date has been slow at National Defence on implementing its new system for issuing orders and directives (policies), the Department has indicated that it is a high priority to achieve full implementation by April 1999.

28.284 Treasury Board Secretariat information. In 1996 we found that the Treasury Board Secretariat did not have all the information it needed from departments to fulfil its role in monitoring and providing leadership across departments.

28.285 The Secretariat reports that it expects that the necessary information technology infrastructure that could assist the materiel management function to perform more effectively will begin to be put in place by 1999-2000. The capability and desirability of using these systems to roll up materiel management information across departments for reporting to central agencies such as the Treasury Board Secretariat will be examined.

28.286 Need for sharing best practices information. In 1996 our audit identified problems that cut across several or all of the organizations we audited, and we found that some organizations with similar problems were addressing them in an unco-ordinated manner.

28.287 The Treasury Board Secretariat reports that it has been active in assisting departments to share information on best practices across government. The Secretariat also supports the Materiel Management Institute in some of its endeavours and participates in the Government of Canada Materiel and Supply Management Steering Committee set up by the materiel management community for professional development, provision of policy advice and input to central agencies.

Major accounting changes

28.288 In 1996 we noted the government's intention to implement full accrual accounting by the 2001-02 fiscal year. This would include capitalization of physical assets and accounting for inventories, two key issues related to materiel management. We reported that the change to accrual accounting would enable the government to report annual costs of programs more realistically, give better information to support decisions and improve accountability.

28.289 In February 1998, the Treasury Board Secretariat issued Treasury Board Accounting Standard 3.1, which provided guidance to departments on the capitalization of capital assets and indicated that other accounting issues, such as inventories, were under review. In Chapter 18 of our September 1998 Report, we reported that as part of its Financial Information Strategy, the government expected that its new central systems would be ready to receive summary-level full accrual-based information from departments starting April 1999. Over the next three years, departments are expected to implement their new financial systems and make the transition from the old central systems to the new. Our future audits will continue to assess the government's progress in this area.

Procurement

28.290 In 1996 we found that not all relevant costs were included in selected materiel acquisitions. We cited the specialized area of ship repairs and overhaul as an illustration. We endorsed the recommendation of an interdepartmental working group that the cost of vessel fuel and crew transportation costs should be a factor in awarding ship repair and refit contracts.

28.291 On 19 December 1996, the Minister of Public Works and Government Services announced that commencing immediately, vessel transfer costs such as fuel costs and crew transportation costs would be included as an evaluation item when soliciting competitive bids for ship repair and refit work.

Disposals

28.292 In 1996 we reported that the use of the Crown Assets Distribution Directorate (CADD), a unit of Public Works and Government Services Canada (PWGSC), remained a mandatory common service for the disposal of surplus Crown assets, despite the 1992 legislative amendments that allowed departments flexibility in disposing of surplus Crown assets (subject to Treasury Board terms and conditions).

28.293 Departmental officials had told us that they could conduct selected disposals themselves more quickly, at less cost, and achieve higher selling prices than CADD. This view was not fully shared by officials at PWGSC. Our review of selected disposal transactions and the success of various disposal pilot projects had confirmed the need at that time for a thorough analysis of existing disposal operations.

28.294 Public Works and Government Services Canada reviewed its disposal operations in 1997. That study, however, did not result in a resolution of the issue of the mandatory use of CADD. The Deputy Minister then recommended examining the possibility of privatizing the CADD function. A contract was awarded to examine the privatization option. The consulting firm engaged for this purpose presented its findings in July 1998 to departmental senior management as well as to a joint steering committee composed of senior officials from PWGSC and the Treasury Board Secretariat.

28.295 Public Works and Government Services Canada and the Treasury Board Secretariat continue to look for the best solution that would help resolve this long-standing controversy. According to the Secretariat, the government will make a final decision on this matter no later than 31 March 1999.

Public Works and Government Services Canada response: Despite the 1992 legislative amendments that allowed departments flexibility in disposing of surplus Crown assets, Public Works and Government Services Canada is obligated to continue performing Crown asset disposal until such time as alternative guidelines and disposal mechanisms are implemented.

Continuing concerns

28.296 Overall, as indicated earlier in this follow-up report, we are generally satisfied with the direction and amount of progress made since our 1996 Report. Nevertheless, we note three areas where we have continuing concerns.

28.297 First, the issue of alternative disposal mechanisms at PWGSC remains unresolved. It is six years since amendments were made to the *Surplus Crown Assets Act* with the intention to allow departments to dispose of surplus assets directly.

28.298 Second, the Treasury Board Secretariat has not made sufficient progress toward strengthening its government-wide monitoring responsibilities. Even in the absence of fully implemented departmental information systems and full accrual accounting, we believe that more could be done so that the Treasury Board Secretariat has a better “big picture” of the status of materiel management in the larger departments of the federal government. For example, departments with important materiel holdings, such as National Defence and Fisheries and Oceans, could be required to report to the Secretariat on major deviations in performance from the departments’ plans.

28.299 Third, the Treasury Board Secretariat needs to provide guidelines and direction to departments concerning the inventory holding costs to be considered when making decisions. Currently, the Secretariat estimates that the annual full cost of holding inventory (including interest on invested capital, warehousing facilities and personnel) is approximately 25 percent of the value of the inventory. However, as departments are not charged interest on the money invested in inventory, they recognize only the direct annual holding costs (such as warehousing facilities and personnel), which are significantly less than the full cost. Not including the interest on invested capital may result in

less than optimal decisions being made, particularly when evaluating inventory options that span several years or more.

28.300 We plan to monitor future progress.

Systems under Development — Getting Results — 1996, Chapter 24

*Assistant Auditor General: Doug Timmins
Principal: Eric Anttila*

Background

28.301 In Chapter 24 of our November 1996 Report of the Auditor General, we reported on our risk assessments of four projects. We recommended that the Treasury Board Secretariat co-operate with departments to produce action plans for the principles discussed in the Enhanced Framework for the Management of Information Technology Projects. In 1997 the Treasury Board Secretariat told us that departments would be expected to develop an improvement plan that focusses on the achievement of goals defined in four plateaus. The first plateau would be March 1998 and the last would be 2002. The plans for the 20 largest departments were to be reported to the Secretariat by March 1998. By the end of September 1998, the Secretariat had received nine of these plans. It has informed us that the others are expected to submit their plans but it is uncertain when this will occur.

28.302 Since September 1997, all new projects submitted by departments for approval by the Secretariat have been required to conform to the best practices in the Enhanced Framework. In addition, the Secretariat has been applying the appropriate principles from the Framework to all Year 2000 projects.

Scope

28.303 The follow-up audit work on the Systems under Development chapter of 1996 was carried out at the Treasury Board Secretariat, Department of National Defence, and at Public Works and Government Services Canada. The findings of the audit were based on interviews with key personnel and review of relevant documentation.

Conclusion

28.304 We agree with the Treasury Board Secretariat that there is still important work to be done in implementing the Framework and in educating senior management on best practices and assuring its commitment to applying them. The work of the Secretariat in obtaining action plans, monitoring their implementation and consulting with departments is clearly not finished. Establishing government-wide mechanisms to assist departments in using the Framework and applying lessons learned from other departments is a key role that the Secretariat can fulfil. It is uniquely positioned for this role since most large information technology (IT) projects are submitted to it for approval.

28.305 Continuing and completing the work begun on the Framework in 1994-95 needs to be a priority. Enormous investments in technology continue and although many departments have made improvements, there are still problems that need to be addressed.

Observations

28.306 Canadian Automated Air Traffic Control System. One of the projects that we reviewed in 1996 was the Canadian Automated Air Traffic Control System (CAATS). This project was transferred to NAV CANADA in November 1996 and is no longer considered to be a major capital project of the government.

28.307 Real Property Services. Management of the Real Property Services set of projects at Public Works and Government Services Canada has continued to pursue the initiatives that we observed in our December 1997 Report. Governance issues such as business planning and priorities are being addressed. The quality assurance function is being established for a number of the projects, and requirements are being defined before contracts are let. Training is available for all managers. The Department is implementing improvements to its systems development processes in line with the Capability Maturity Model of the Software Engineering Institute. In addition, an innovative approach to project monitoring called the Project Control Panel has been adopted. Project sponsors from the business areas have been identified to ensure that projects remain aligned with business needs. The Department is fully involved with the Treasury Board Secretariat to implement the guidance offered in the Secretariat's Enhanced Framework for the Management of Information Technology Projects.

28.308 Tactical Command, Control and Communications System. The Tactical Command, Control and Communications System (TCCCS) at National Defence is experiencing a one-year delay that is pushing final implementation from September 2000 to September 2001. The overall budget, however, is expected to remain the same. Although some elements of the system have been delivered, the impact on training and operational plans of the Army is significant. A contract amendment is being finalized to establish a new timetable and better project control mechanisms. TCCCS is a complex project that involves some high-risk development work, but the project management team assures us that it is in control and expects to meet its commitments. We will continue to monitor this project, as its overall cost of \$2 billion 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.

28.309 Canadian Forces Supply System Upgrade. The Canadian Forces Supply System Upgrade project (CFSSU) was initiated by National Defence in 1981 and approved by the Treasury Board in 1985. A contract was signed in January 1995 and the end of the project was expected in January 1999. When we reported on it in November 1996, the project represented a high risk of being late, of going over budget and of not meeting the Department's requirements. Over the past two years, National Defence management and the contractor have switched from a custom-built solution to an off-the-shelf one in an effort to reduce risk. In our December 1997 Report, we reported a revised target date of September 1999. However, as of September 1998, an additional five-month delay had already been recognized and negotiations were under way to establish a new timetable for final delivery of the system. The project management team still expects to meet its overall budget of \$295 million. Although CFSSU remains a high-risk project, we are encouraged by management's efforts to contain both costs and delays while meeting the core requirements for the system.

28.310 Action is under way to address recommendations for both CFSSU and TCCCS. As new project phases or contract amendments are worked out, the National Defence project teams have been striving to meet some of our key recommendations on large systems under development projects. These efforts include:

- taking particular care to establish clear project milestones and conditions for their achievement;
- putting in place appropriate performance indicators to better monitor work toward project achievements;
- designating a project leader at the assistant deputy minister level to be fully responsible for the projects and briefing the leader regularly on progress and project challenges; and
- establishing priorities of time, cost and requirements for project management teams. Exceptions are accepted only after thorough analyses and negotiations with the suppliers.

The Canadian Intelligence Community — Control and Accountability — 1996, Chapter 27

Assistant Auditor General: David Rattray

Principal: Henno Moenting

Background

28.311 In our 1996 audit, we concluded that although substantial arrangements were in place for control and accountability in the Canadian intelligence community, there were opportunities to strengthen them further. We noted that improvements in certain areas, such as community leadership and co-ordination, ministerial direction in the departments of National Defence and Foreign Affairs and International Trade, and performance measurement in the key intelligence collection agencies, would help the community respond to the challenges of a rapidly changing intelligence environment and growing public expectations for improved control and accountability of all public institutions.

Scope

28.312 Our follow-up work included a review of the 1997 status report prepared for the Standing Committee on Public Accounts by the Co-ordinator of Security and Intelligence on the progress made in relation to our observations in 1996. We also reviewed a 1998 update of that status report. We conducted interviews and had discussions with officials in all of the agencies and units that collect, analyze and disseminate foreign and security intelligence as well as those that co-ordinate or review their operations. In addition, we reviewed supporting documentation.

Conclusion

28.313 Based on our follow-up review, we concluded that there has been further progress in strengthening control and accountability arrangements in Canada's intelligence community. The community has taken action to respond to most of the observations we made in 1996. However, some initiatives are still incomplete.

Observations

Leadership and co-ordination of the intelligence community have been strengthened

28.314 In the area of assessments, the Intelligence Assessments Committee (IAC) and the Intelligence Assessment Secretariat have taken steps to ensure that intelligence assessments respond to the needs of the Prime Minister, Cabinet and ministers. The community has also continued to explore ways to strengthen the contribution to its products. Recent work plans call for contributions from a wider range of organizations in producing assessments. In addition, standing representation at regular IAC meetings has been expanded.

28.315 To aid in managing resources, a strategic review of resource pressures is being conducted at the request of the Co-ordinator of Security and Intelligence.

28.316 Following a 1997 review, the Intelligence Policy Group (IPG) moved to improve the strategic management and co-ordination of relationships with intelligence services of other countries. The IPG and the Interdepartmental

Committee on Security and Intelligence (ICSI) regularly discuss and assess the nature of co-operation and these relationships as a whole.

The process for establishing and communicating national intelligence priorities has been enhanced

28.317 Given the broad range of intelligence requirements and issues, ministerial involvement in the annual process of setting intelligence priorities continues to be a key element in the control and accountability regime for the Canadian intelligence community. We found that the timeliness of ministers' approval of the national intelligence requirements has improved. Priorities for both 1997-98 and 1998-99 were approved before the end of the preceding fiscal years. In addition, following their approval by ministers, the Co-ordinator of Security and Intelligence now conveys the foreign intelligence priorities formally in writing to ICSI members.

Some steps have been taken to integrate monitoring of community-wide performance with government priority setting and resource management

28.318 In 1997-98, the intelligence community used the national priorities and the results of consultations with intelligence users to identify major collection gaps in a specific and significant collection program, and to take action as appropriate. Although this initiative and the review of resource pressures currently under way (see paragraph 28.315) contribute to the monitoring of community-wide performance, we believe there would be merit in considering the establishment of systematic and ongoing mechanisms for collection agencies to demonstrate results achieved in relation to agreed expectations.

Ministerial control and accountability in the departments of National Defence and Foreign Affairs and International Trade have been strengthened

28.319 To reinforce appropriate ministerial control and accountability, Foreign Affairs and International Trade has consolidated into one document all practices and procedures for managing foreign intelligence activities. The Minister of Foreign Affairs approved this document in late 1996. We believe this document could be used in the future as a basis for periodic reviews or audits to assure the Minister that the arrangements are working as intended.

28.320 The Department of National Defence (DND) has taken some initial steps toward strengthening ministerial control and accountability of its intelligence activities. The Director General, Intelligence, in consultation with the Judge Advocate General, has produced an Intelligence Activity Authority Matrix describing all DND collection activities, their legal basis and the approving authority. This draft document has yet to be approved by the Deputy Minister and Chief of Defence Staff; however, DND officials anticipate ministerial review and approval before the end of 1998.

Legislative framework for the Communications Security Establishment

28.321 The government has yet to act directly on our observation that a legislative framework for the Communications Security Establishment (CSE) could be of value. Similar recommendations were also made by the Privacy Commissioner (in 1996) and the Communications Security Establishment Commissioner (in 1997). Community officials told us that no decision had yet been made on how to respond to these recommendations.

28.322 At the request of the Co-ordinator of Security and Intelligence, CSE initiated a Mandate and Authorities Project in 1997 to clarify and improve its accountability and policy frameworks. Among other things, the project is designed to strengthen governance and establish a closer accountability relationship between the Chief of CSE and the Minister. CSE officials noted that the accountability framework resulting from this project could be one of the elements helpful to the development of legislation, should the government choose that option.

Plans are under way to conduct compliance reviews in the Communications Security Establishment

28.323 The Communications Security Establishment has established a policy framework that will facilitate future reviews, and is preparing to conduct additional reviews of compliance with its internal policies. A new position, Director of Review Services, has been created and recently staffed. An early task for the Director of Review Services will be to update CSE's review work plan, which will include review priorities.

28.324 We note also that the Communications Security Establishment Commissioner, who was appointed in June 1996 for a three-year term, has been active since his appointment in reviewing CSE's activities to determine whether they comply with applicable laws. The Commissioner has issued two public annual reports during this period and submitted a number of additional reports to the Minister of National Defence.

Relations between the Security Intelligence Review Committee and Parliament have improved

28.325 The Sub-Committee on National Security has not been reconstituted in the present Parliament. New relations are in the process of being developed between Parliament and the Security Intelligence Review Committee (SIRC). In this context, we were informed that appearances by SIRC members and officials before parliamentary committees have gone well in terms of tone and relationships.

Working relations between the Canadian Security Intelligence Service (CSIS) and the Inspector General of CSIS are being monitored

28.326 Although the Inspector General's position is currently vacant, we noted that there had been dialogue during the past two years among the Solicitor General, the Deputy Solicitor General, the Director of the Canadian Security Intelligence Service (CSIS) and the Inspector General on overall relationships. In addition, while the Inspector General provides independent advice to the Solicitor General, we were told that senior government officials regularly monitor working relations and arrangements.

Performance measurement in the Communications Security Establishment and the Canadian Security Intelligence Service has improved

28.327 A responsibility centre for planning, policy and performance measurement for CSE's signals intelligence (SIGINT) activity has been created, and the development of performance measures and success indicators has begun in the context of the business planning process for 1998-99. In addition, CSE has continued to refine the on-line customer requirements and feedback system implemented in 1996. This has improved its ability to measure the performance of its SIGINT program, including assessing the relative contributions of various collection sources to successful SIGINT reporting.

28.328 CSIS officials told us that performance indicators have been developed in a number of program areas, but noted that some aspects of the agency's performance are not readily measurable. The agency is currently studying ways to identify meaningful connections between performance indicators and operational costing.

Agriculture and Agri-Food Canada — The Western Grain Transition Payments Program — 1996, Chapter 28

Assistant Auditor General: Don Young
Principal: Neil Maxwell

Background

28.329 The Western Grain Transition Payments Program provided \$1.6 billion to Prairie landowners to compensate for the forecasted decline in land values due to the end of the *Western Grain Transportation Act* (Crow Benefit) transportation subsidy in 1995. The decision to end the long-standing subsidy was one component of a significant change in government policy, aimed at reforming the Western grain transportation system. The Program's design and administration were the responsibility of Agriculture and Agri-Food Canada.

28.330 At the time of the audit, the Department had gathered and processed sufficient data for 209,887 landowners to receive an interim payment equal to approximately 71 percent of the total entitlement from the Program. The Program is now complete with the last payment distributed in the 1996-1997 fiscal year.

28.331 Our 1996 audit found that the payments were calculated according to the Program's enabling Act and regulations. We also found that the Department made substantial efforts to ensure that the payments were made on a timely basis. In addition, we performed a limited review of the key internal controls governing the payment process. Nothing came to our attention in the course of this review to suggest that there were significant problems with these payments.

Scope

28.332 The objectives of our 1998 follow-up were to determine the status of our 1996 recommendations, and to note any other significant matters that came to our attention.

Conclusion

28.333 In general, the Department has taken appropriate steps to implement our recommendations concerning the monitoring and assessment of the aftermath of the Western Grain Transition Payments Program and the end of the Crow Benefit. Given the circumstances, the current approach is reasonable although we would encourage the Department to establish an earlier target date than 2007 for assessing changes. In addition, we would encourage the Department to consider a broader assessment that could incorporate social and environmental impacts.

Observations

28.334 Based on our audit findings in 1996, we made two recommendations. First, we recommended that the Department evaluate the Program to capture lessons for future programs and to assess its impacts, both intended and unintended. The Department has met part of the requirements of this first recommendation by completing a lessons-learned study that looked at implementation of the Program. The study, completed in late 1996, indicated that the Program's administration compared favourably with best practices in its delivery, sound financial management and

the quality of client service. The Department is proud of its accomplishments and has circulated copies of the study both within Agriculture and Agri-Food Canada and to other federal departments.

28.335 Our second recommendation in 1996 was that the Department assess the direction of changes over the long term that were related to crop diversification and the development of value-added processing industries and that were predicted to occur as a result of transportation changes in Western Canada. The Department is currently addressing this recommendation by monitoring four areas: comparative land values between the United States and Canada; on-farm investment as measured by Statistics Canada; level of crop diversification away from traditional grains and oil seeds; and collection of information on specific investments in the value-added processing industry. Officials expect to continue monitoring until the year 2007, at which time they plan to analyze and publicly report on the extent of change in diversification and value-added processing industries, and in land values.

28.336 We questioned departmental officials about why no report would be prepared sooner and they responded that this period would allow enough time for all the resulting changes to take place. Officials told us that it would be possible to produce a report earlier, based on a shorter period of assessment, but there has been no evident demand for an earlier report. They also told us that in the meantime, they intend to use this information as input to possible changes in federal grain policy.

28.337 Although the Department has done a lessons-learned study and is monitoring long-term economic impacts, it is not presently doing a full evaluation of the intended and unintended impacts of the Program. Most of the economic elements that we expected to see in such an evaluation, such as changes in land values, are part of the long-term monitoring mentioned previously. However, many of the possible unintended impacts of the Program and of the ending of the Crow Benefit are not economic but environmental and social, and are not part of the monitoring regime. Officials told us that they would be willing to broaden their approach to incorporate the monitoring of social and environmental changes. They also pointed out that it would be difficult in practice to attribute changes to specific policies and programs of the federal government and, in particular, connect them directly to the Western Grain Transition Payments Program and the end of the Crow Benefit.

Canadian Heritage — Parks Canada — Preserving Canada's Natural Heritage — 1996, Chapter 31

Assistant Auditor General: Richard Flageole
Principal: Ginette Moreau

Background

28.338 Our follow-up audit reviewed corrective action and progress by Parks Canada on the 14 recommendations in Chapter 31 of our November 1996 Report. The purpose of this follow-up was to determine whether the actions taken have corrected, or are correcting, the deficiencies identified in our 1996 audit. The main issues we raised in 1996 concerned the planning systems and management systems of existing national parks. More specific issues were the protection of ecological integrity and the establishment of new national parks and marine conservation areas to complete Canada's network of protected areas.

Scope

28.339 We reviewed the 30 June 1997 progress report from Parks Canada to the Standing Committee on Public Accounts. We also incorporated relevant information obtained from Parks Canada and interviewed officials in Ottawa and in the regions.

Conclusion

28.340 Since the 1996 audit, Parks Canada has made some progress in implementing our recommendations, and has demonstrated a willingness to review its actions and to refocus its management. While it has streamlined its organization and operations and developed comprehensive plans to address outstanding issues, how these efforts will be implemented at the park level remains to be seen. While no new parks have been created since 1996, work is continuing toward completing the national parks system. However, it is becoming increasingly clear that the system will not be complete by the year 2000. Although work is also under way to create new marine conservation areas, Parks Canada has not created any new areas since 1990.

Observations

Parks Canada is providing direction on what it is striving to achieve in the future

28.341 The *Banff-Bow Valley: "At the Crossroads" Report*, prepared by an independent task force and released in October 1996, has had an impact on the management of Banff National Park. It is hoped that it will also affect the way all national parks are managed in the future. In releasing the report, the Minister reaffirmed Parks Canada's mandate as stated in the *National Parks Act* and *Parks Canada: Guiding Principles and Operational Policies* — that nature and ecological integrity will continue to be its first priority while it manages visitor use.

28.342 The Banff National Park Management Plan was released in April 1997. According to the Minister's prefacing message, the Plan incorporates many of the recommendations of the Banff-Bow Valley Report and is "the blueprint for action into the 21st century" and "could be a model for all parks." We believe that Parks Canada would

benefit from reflecting the recommendations of the Banff–Bow Valley Report as soon as possible in the management plans of other parks.

28.343 The 1997 State of the Parks Report released in July 1998 contains a lot more comprehensive and valuable information on the situation of national parks in Canada than the 1994 Report. There are 38 national parks and three marine conservation areas in Canada. The Report indicates that the ecological integrity of 30 national parks is impaired; and in 13 national parks this trend has increased over recent years. In addition, 22 parks have been identified as having severe or major environmental impacts from external sources. The Report provides limited information on the existing marine conservation areas and on progress in establishing new ones.

28.344 We noted that the two previous State of the Parks Reports were presented in 1990 and 1994 respectively. We encourage Parks Canada to respect the obligation to produce the Report every two years, as required under the *National Parks Act*.

Improved collection and use of biophysical and visitor–use baseline data is a prerequisite of future protection and management of national parks

28.345 We believe that Parks Canada has given the importance of biophysical and visitor–use data bases for national parks increased recognition. However, we noted that the quality and quantity of the information included in those data bases varies among parks. The level of effort on data collection presently depends to a large extent on resources available to park superintendents. Parks Canada will need to give a higher priority to acquiring, updating and analyzing the information contained in the data bases for all its parks. This will facilitate the choice of ecological integrity indicators and the development of appropriate monitoring programs.

28.346 The Banff–Bow Valley Report indicated the need to manage visitor use of parks or specific areas where ecological integrity is threatened or likely to be threatened. The decision to act and the justification for controlling access is dependent on having a set of benchmarks, built on sound data bases, against which changes can be measured and impacts better assessed. Without such benchmarks, damage to the ecological integrity of a site could go unnoticed until it is too late to be rectified.

28.347 Despite the efforts of Parks Canada to move forward in developing ecological integrity indicators, among other things, it has not been able to prevent an increase in the threat, from both external and internal sources, to the ecological integrity of most national parks. Although the government has made a commitment to establish a multilateral panel of experts to review the overall performance of the national parks system in protecting ecological integrity, action has not yet been taken.

Park management plans need to be updated on a timely basis and ecological integrity components developed

28.348 As of September 1998, 16 national parks still did not have up–to–date park management plans. Parks Canada informs us that it is addressing this shortcoming as a priority item, and we encourage action to correct this situation as soon as possible.

28.349 To date, only 21 national parks report having prepared ecological integrity statements (EIS) or drafts of such documents. In its report entitled *Ecological Integrity Statements for National Parks: A Guide to Their Preparation*, Parks Canada committed to completing the preparation of statements for all parks by June 1998; it has since revised the target to March 1999. Further delays could prove costly in the long term to both ecological protection in national parks and the credibility of Parks Canada with the public.

28.350 According to the information gathered from individual parks, 27 national parks report the existence, in whole or in part, of ecological integrity monitoring programs. At least seven of these parks have implemented monitoring programs without first having prepared an EIS. Their monitoring programs rely instead on previously

approved management plans and ecosystem conservation plans. We expect that the development of ecological integrity statements will lead to a more uniform application of monitoring programs in all parts of the national parks system.

The establishment of national parks and marine conservation areas remains a priority

28.351 On 25 November 1992, the federal government and all provincial and territorial governments signed the *Tri-Council Statement of Commitment to Complete Canada's Networks of Protected Area*. This committed them to make every effort to complete their representative protected area networks by the year 2000. The national parks system is based on having each of the country's 39 natural regions represented by a national park. A preferred park area has not yet been selected in five of the 15 natural regions not yet represented, although potential sites have been identified. Parks Canada officials indicated that the selection is difficult because it requires reaching an agreement with provincial and/or territorial governments and, in some cases, Aboriginal groups and other stakeholders. This situation seriously limits the actions that Parks Canada can undertake to complete the national parks system by the year 2000.

28.352 In 1996 we recommended that Parks Canada update and release its National Parks System Plan and an action plan for completing the national parks system. Although the National Parks System Plan was updated in February 1997, we were informed that there would be no formal action plan. The 1997 State of the Parks Report gives some indication of actions being taken to complete the system. Parks Canada intends to establish four new marine conservation areas over the next five years. However, there is no action plan for marine conservation areas and none will be prepared. It appears that Parks Canada establishes its priorities on a case-by-case basis, depending on the willingness of partners to proceed. We believe that a more proactive approach is needed.

28.353 In its response to our 1996 audit, Parks Canada stated that pursuant to government direction, it would maintain the course that leads to national parks being owned by all Canadians and managed on behalf of all Canadians. In fact, the *National Parks Act* requires federal government ownership of any national parks land. We are concerned that this requirement will prevent the representation of all natural regions in the national parks system. If action is not taken soon, targeted or potential lands could be developed, leaving no likelihood that Canada or other levels of government will attain publicly stated goals. For that reason, we reiterate our recommendation that Parks Canada study alternative approaches to ensuring that all natural regions are represented.

28.354 In its progress report of 30 June 1997, Parks Canada indicated that amendments to the *National Parks Act* were being prepared to enable the government to add new national parks or enlarge existing ones through a streamlined legislative process, without having to introduce legislation in Parliament. Although this commitment was undertaken in 1994, legislative changes have yet to be presented. Consequently, eight of Canada's national parks are still not protected under the *National Parks Act*.

Canadian Heritage — Parks Canada — Management of Historic Canals — 1996, Chapter 32

Assistant Auditor General: Richard Flageole
Principal: Ginette Moreau

Background

28.355 In 1996 we reported on the management of historic canals by Parks Canada. We made a number of observations concerning accountability as well as strategic, operational and cost-effective management of canals. Our 1996 audit and this follow-up focussed on the management of the Rideau Canal and Trent-Severn Waterway, as these two canals represent over 75 percent of total canal operating costs and the majority of boats moving through locks.

Scope

28.356 We reviewed the status report prepared for the Public Accounts Committee by Parks Canada. We also reviewed the supporting documentation provided to us by Parks Canada and had discussions with its officials.

Conclusion

28.357 Parks Canada has taken steps since 1996 that respond to certain of our recommendations, although progress to address them fully has been slow. We noted that Parks Canada has streamlined its organization and enhanced its program accountability; however, continued attention by management is needed to achieve the projected revenue targets of Parks Canada and thus to continue reducing the gap between revenue and operating expenditure. Parks Canada needs to continue improving the quality of its cost information on canal services and the quality of information on client needs. Better information will support its efforts to promote heritage values and could increase the demand for its services.

Observations

Parks Canada has introduced a more integrated and results-oriented business planning process

28.358 In 1996 we found that the management plans and the business plans of the Rideau Canal and Trent-Severn Waterway did not present a realistic option for the future. They lacked specific operational objectives and time frames for which canal management could be held accountable. Our follow-up review indicates that Parks Canada has introduced a new business planning process for 1998-99. The process integrates into business planning important elements such as the management plans, the commemorative integrity statements and the strategic direction of Parks Canada.

28.359 In the revised planning process, the purpose of the management plan is to indicate the general direction for protection of heritage resources and for the long-term development of each site. The annual business plan identifies the actions, the priorities and the resources required to achieve the intended objectives. Since 1996, the management plans for the Rideau and Trent-Severn have not been modified and therefore still do not, in our opinion, present a realistic option for the future. The new business plans for both canals begin to address the issue of clearer objectives

and associated activities, but they still need some work. The new planning process also requires each site to report on progress annually. The first annual reports will be produced at the end of the 1998-99 fiscal year. We are therefore unable at present to assess the full benefit of the annual reporting of results against objectives.

28.360 As a result of its most recent reorganization, Parks Canada has clarified the accountability regime and established a direct line of accountability between senior management responsible for the Rideau Canal and Trent-Severn Waterway and the Assistant Deputy Minister responsible for Parks Canada.

Parks Canada needs to reaffirm its strategy to achieve reduced operating costs and increased revenue at the canals

28.361 In 1996 we noted that Parks Canada had established specific revenue generation and cost reduction targets for the Rideau and Trent-Severn: operating costs were to be reduced by \$3.2 million from 1995-96 to 1997-98. Revenue was to be increased from \$2 million to \$4.8 million from 1995-96 to 1998-99.

28.362 Parks Canada achieved its operating-cost reduction target over the three-year period, but it has not yet achieved its revenue target. At the end of 1997-98, revenue had increased by only \$793,000. However, total revenue for the Trent-Severn and Rideau, which covered 8.9 percent of the total operating costs in 1994-95, now covers 16.6 percent of the total operating costs in 1997-98.

28.363 During our follow-up, we found that, as part of the 1998-99 business planning exercise, Parks Canada has adopted a more realistic revenue generation target for the Rideau Canal and the Trent-Severn Waterway. In order to achieve this objective, Parks Canada must continue to clearly define the measures it intends to implement to further reduce the gap between revenue and operating costs.

28.364 In 1996 we noted that Parks Canada could further reduce operating expenses and increase its revenue. For example, we commented on the need to consider shortening the hours of operation for certain canal locks and/or close infrequently used locks in the Rideau Canal and Trent-Severn Waterway as a means of reducing its operating costs. However, Parks Canada remains committed to maintaining the same hours of operation for the canals until the year 2000 and to maintaining through navigation for the entire Rideau Canal and Trent-Severn Waterway. It considers that part of the canals' commemorative and historical value is based on the fact that both canals are fully operational man-made canal systems that extend over several hundred kilometres.

28.365 We also noted in 1996 that Parks Canada considered the area of realty rights and privileges to be a major source of revenue growth and that fees would be implemented on a full cost recovery basis. Parks Canada has yet to fully implement these fees, which is one of the reasons it has not achieved its revenue targets.

Parks Canada needs better information on customer needs to increase demand for canal services

28.366 Parks Canada is committed to promoting heritage values and to increasing demand for its various services through marketing initiatives and forging new partnerships with private and public sector stakeholders. We recognize that increased demand does not automatically translate into revenue at Parks Canada, because some of its services relate directly to its mandate of protection and presentation of cultural resources. The fees that Parks Canada charges for its revenue-generating services can also adversely affect demand. In our opinion, Parks Canada ought to have a better understanding of the needs of its customers and the elasticity of the demand for its services. It is also not clear to what degree Parks Canada's ad hoc marketing initiatives or discussions with stakeholders have succeeded, or resulted in increased demand from either water-based or land-based visitors.

28.367 An important element of choosing effective marketing strategies and initiatives is understanding the needs of the clientele. Since 1996, Parks Canada has made some improvements to the information on canal visitors at the

Trent-Severn Waterway and Rideau Canal. We believe that the information currently gathered is insufficient and that Parks Canada needs more relevant and reliable information on its visitors, for management decision making and to contribute to marketing strategies aimed at increasing the demand for canal services.

28.368 Both canals are re-examining their marketing approach. The current marketing plan for the Rideau Canal is outdated; the Trent-Severn Waterway marketing plan lists numerous initiatives but it is not clear how those initiatives will be carried out or who will carry them out. Furthermore, we could not obtain any analysis or report that measures progress or degree of success in achieving the marketing objectives of either marketing plan. We believe that in order to have an impact on demand, both canals still need to select the most appropriate marketing strategies and determine the most effective means to carry them out.

Quality of financial information still requires attention

28.369 Parks Canada will need reliable and detailed cost information for all of its services. This would help it to identify areas where further economies or cost efficiencies can be realized and to establish fair and equitable fees.

28.370 The quality of cost information for the various canal services, which include navigation, water management and flood control, has not improved since 1996. This lack of information prevents Parks Canada from accurately determining the cost of its services and making informed decisions on cost reductions and/or cost recovery that could contribute to the achievement of further reductions. On 1 April 1998, Canadian Heritage introduced a new Integrated Financial and Material System (IFMS), but managers responsible for the Rideau Canal and the Trent-Severn Waterway have yet to benefit from its intended superior cost-reporting capabilities.

28.371 The lack of cost information also has a direct impact on Parks Canada's ability to analyze the public and private benefits and to establish fair and equitable fees. As noted in 1996, accurately determining the cost of its services and the primary beneficiaries is vital to establish user fees that are fair both to individuals who receive personal benefits and to taxpayers. We recommended that Parks Canada conduct a rigorous analysis of public and private benefits derived from canal systems in order to properly support the establishment of user fees. Such an analysis has not yet been conducted.

28.372 Parks Canada recently approved a *Parks Canada Revenue Policy* (May 1998). The policy defines what Parks Canada considers to be a public or private benefit and addresses the relationship among fees, pricing and cost recovery objectives. It requires that fee proposals be submitted as part of the new business planning process (beginning in 1999-2000) before consultations are initiated with the public. We believe that this new policy is a good first step and, combined with better-quality cost information from the new IFMS, that it should help Parks Canada to make better-informed decisions.

Revenue Canada and Department of Finance — Goods and Services Tax: New Housing Rebate and “Self-Supply” — 1996, Chapter 36

Assistant Auditor General: Shahid Minto
Principal: James Ralston

Background

28.373 Our 1996 chapter focussed on the administration of the GST New Housing Rebate program and of the “self-supply” rules applicable to multiple-unit residential complexes. We also examined how Revenue Canada and the Department of Finance responded to the risk of non-compliance or of difficulties in achieving program objectives.

We recommended that the Department of Finance and Revenue Canada:

- perform an evaluation of the New Housing Rebate program;
- evaluate Revenue Canada’s voluntary disclosure policy; and
- continue to monitor evolving jurisprudence regarding the “house hopper” issue.

We also recommended that Revenue Canada:

- assess whether, on a national basis, there is sufficient audit coverage of builders;
- consider the merits of having a national audit project to address the problem of non-compliance with the self-supply rules;
- ensure that reliable and appropriate information with which to manage the New Housing Rebate program is available on a timely basis; and
- provide guidance on the minimum standard of due diligence expected from builders when determining the eligibility of purchasers from whom they accept an assignment of the New Housing Rebate.

Revenue Canada’s records show payments of \$303 million, \$338 million and \$420 million made under the New Housing Rebate program for the years ended 31 March 1996, 1997 and 1998 respectively.

Scope

28.374 Our follow-up consisted mainly of a review of status reports prepared by Revenue Canada in June and July 1998 on the actions taken to address the 1996 recommendations. We also reviewed supporting documentation and conducted interviews with Revenue Canada and the Department of Finance to discuss and assess actions taken.

Conclusion

28.375 Revenue Canada has initiated action to address many of the recommendations we raised in 1996. It has initiated changes to its voluntary disclosure policy to encourage GST registrants to come forward and correct their

accounts. Results of the evolving jurisprudence regarding “house hoppers” indicate a legislative amendment to the *Excise Tax Act* may not be necessary.

28.376 Work remains to be completed in some areas. Revenue Canada has made some improvements to its processing and reporting system for the New Housing Rebate program, but other enhancements are not yet completed. Projects designed to ensure sufficient national audit coverage of builders were not in place at the time of our follow-up. In addition, a review proposed by Revenue Canada to evaluate the merits of having a national audit project to address the problem of non-compliance with the self-supply rules has not yet been undertaken. The Department has advised us it intends to initiate projects ensuring sufficient audit coverage of builders and the “self-supply” rules by the end of September 1998.

28.377 The Department of Finance and Revenue Canada have no plans to conduct a program evaluation of the New Housing Rebate program. Revenue Canada has also indicated that it feels current guidance on due diligence is sufficient for builders accepting assignment of the New Housing Rebate from purchasers.

Observations

Program evaluation

28.378 Based on a preliminary analysis of the housing market after the implementation of the GST, the Department of Finance does not believe that an evaluation of the New Housing Rebate program is warranted. According to Revenue Canada, it will continue to evaluate the effectiveness of the program by monitoring jurisprudence and through consultation with the Department of Finance and key stakeholders.

Voluntary disclosure

28.379 As a result of the policy review to develop a harmonized disclosure policy for income tax and GST, Revenue Canada has eliminated the six-percent penalty for taxpayers who voluntarily come forward to correct their GST accounts. It believes that this will be an incentive for GST registrants to come forward and voluntarily correct any reporting deficiencies. In addition, the Department has informed us that it has instituted a recording system to track GST voluntary disclosures. Revenue Canada is looking at further changes to the voluntary disclosure policy and, because some of the proposed changes are tied into enforcement actions taken by provincial tax administrations, it is consulting with the provinces.

Monitoring jurisprudence regarding “house hoppers”

28.380 In our 1996 chapter, we expressed concern that a provision of the *Excise Tax Act* that is meant to provide equitable treatment for unincorporated professional builders who construct homes for their personal use may be used by small-scale builders to build homes for resale in a manner that avoids the GST. The term “house hopper” was coined to refer to the individuals involved in such activity. We recommended that Revenue Canada and Finance monitor the evolving jurisprudence in order to determine whether there is a technical problem with the wording of the Act that would need to be remedied by way of legislative amendment.

28.381 Since 1996, the majority of the court cases relating to “house hoppers”, including the result of a judicial review by the Federal Court of Appeal in July 1997, have been settled in favour of Revenue Canada. In view of this fact, Revenue Canada believes a legislative amendment to the *Excise Tax Act* will likely not be necessary.

Sufficient audit coverage of builders

28.382 Revenue Canada has informed us it is taking steps to ensure that there is sufficient coverage of builders. Recent improvements in the Department's risk assessment system will enable better identification of files with tax at risk, including those in the construction sector. In addition, the information relating to New Housing Rebate payments that are assigned to builders will serve as an additional tool in the selection of workload. The Department planned to send this information to its Tax Services Offices by the end of September 1998 for use in selecting and initiating projects. Since the projects were not in place at the time of our follow-up, we are not yet able to assess the impact of this initiative.

Project on "self-supply" rules

28.383 Revenue Canada's review of the merits of having a national project to address the problem of non-compliance with the "self-supply" rules applicable to builders of multiple-unit residential complexes has been delayed. However, the Department informed us that by the end of September 1998 it would advise all Tax Services Offices to initiate projects related to the application of the "self-supply" rules. Since the projects were not in place at the time of our follow-up, we are not yet able to assess the impact of this initiative.

Information for management

28.384 Some changes to the Revenue Canada processing and reporting system for the New Housing Rebate program have been made so that some national statistics are now prepared on a regular basis. Information to determine work flow, such as reasons why claims are rejected, is not available in the system. Enhancements to the system to produce additional information have not been started due to limited programming resources.

Guidance to builders accepting assignment of New Housing Rebates

28.385 Revenue Canada does not believe there is a need for additional guidance on due diligence to builders accepting assignment of the New Housing Rebate from purchasers. The Department is satisfied to continue the practices we observed at the time of our 1996 audit. These consist of working through industry associations to improve the flow of information and the understanding of eligibility of purchasers for the New Housing Rebate, and providing reminders to the building community.

Revenue Canada — Enforcing the *Income Tax Act* for Large Corporations — 1996, Chapter 37

Assistant Auditor General: Shahid Minto

Principal: Jamie Hood

Background

28.386 In our 1996 audit of Revenue Canada's large file program, we made a number of observations and recommendations about legislative gaps, the way auditors select the issues to audit, the backlog of audits, the reporting of audit results and certain human resource problems.

Scope

28.387 Our follow-up in 1998 included a review of the status report prepared by Revenue Canada on the progress made in addressing our 1996 recommendations. We also reviewed the supporting documentation provided to us by the Department and had discussions with its officials.

Conclusion

28.388 Revenue Canada has taken some action to address several of our recommendations. However, much remains to be done and we are concerned that the problems we identified in 1996 still persist because of the length of time it is taking to address them.

Observations

Use of administrative policies to deal with legislative gaps

28.389 In 1996 we recommended that Revenue Canada and the Department of Finance continue to consult so that legislative changes to reflect accepted administrative policies could be recommended to Parliament sooner. We note in 1998 that there are ongoing consultations between the two departments on such issues.

28.390 With respect to the two particular administrative policies we identified in the 1996 chapter, there have as yet been no recommendations to Parliament to change the legislation. This is particularly troubling in the area of interest deductibility, where the administrative policy does not fully reflect the law as interpreted by the courts.

28.391 The second administrative policy dealt with the utilization of losses within a corporate group. The Minister of Finance's Technical Committee on Business Taxation raised this issue in its report and the Department of Finance is currently studying that report.

Improvements are still needed in audit practices and reporting of program results

28.392 Selecting the right issues to audit is a primary key to success. In 1996 we noted several opportunities for Revenue Canada to help its auditors improve the process they use to select audit issues and to give management the assurance that the highest-risk areas of possible non-compliance are being reviewed. The Department issued some

directives about this subject earlier this year and has plans to issue others. However, it will take some time for the information contained in the directives to be reflected in the way auditors do their work. We encourage the Department to issue the remaining directives as quickly as possible and to provide appropriate training to its auditors so that the recommended approaches are fully understood and applied.

28.393 In 1996 we noted that the Department had an action plan to reduce the interval between the time a return is assessed and the time it is audited. Improvements continue to be made in this area.

28.394 Providing Parliament with complete information on program results is important. In 1996 we recommended that Revenue Canada supplement the information it reported to Parliament on the results of the large file program with information on actual taxes billed or refunded and information on subsequent appeals. We recognize that there has been a change in the Estimates documents since 1996. However, our review of both Revenue Canada's 1998-99 Report on Plans and Priorities and its 1997-98 Performance Report show that less information is now being provided to Parliament on the results of the large file program than was the case in 1996. We are convinced that the Department needs to find ways within the new structure to fully implement our 1996 recommendation.

Some human resource problems persist

28.395 We observed a number of human resource issues in 1996 that were creating barriers to achieving better results in the large file program and we made several recommendations for improvements. In our follow-up we found that the Department has made some progress in addressing our recommendations, particularly through the staffing design team for the proposed Canada Customs and Revenue Agency, although there are still difficulties in staffing positions in some regions.

Chapter 29

Other Audit Observations

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Other Audit Observations

Main Points

29.1 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.

29.2 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.

29.3 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.

29.4 Observations reported this year cover the following:

- ongoing issues between Atomic Energy of Canada Limited and the government that need to be resolved;
- transparency and the government’s Annual Financial Report;
- concerns about poor control over computers loaned to employees for home use;
- the urgent need for an updated long-term comprehensive plan to restore and renovate the Parliamentary Precinct; and
- fairness in the Canadian income tax system.

29.5 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

29.6 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.

29.7 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.

29.8 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.

Atomic Energy of Canada Limited

Assistant Auditor General: John Wiersema
Director: Dale Shier

Ongoing issues between Atomic Energy of Canada Limited and the government need to be resolved

While the government has approved Atomic Energy of Canada Limited's (AECL) annual operating and capital budgets, in each of the past three years it has not approved AECL's five-year corporate plans. Consequently, the related corporate plan summaries have not been tabled in Parliament. There are no other situations where a Crown corporation's corporate plan has not been approved for three years. In the circumstances, the process contemplated in the Financial Administration Act (FAA) for approval of a Crown corporation's objectives and its strategies for achieving them is not functioning in the case of AECL. Further, Parliament's needs for timely information on AECL's plans, communicated through a corporate plan summary, are not being met as contemplated by the FAA.

Atomic Energy of Canada Limited and the government are working together to resolve outstanding issues, including the future of Whiteshell Laboratories and responsibilities related to nuclear waste. Resolution should provide consensus on important issues, and allow the corporation to manage its business with that consensus in mind. In our view, it is important that these current efforts succeed.

Background

29.9 As part of its Program Review of government operations, the government reviewed Atomic Energy of Canada Limited's operations about two years ago. This review confirmed government support for AECL, but resulted in decreases in the government's annual funding of the corporation's nuclear research activities. In 1996-97, the government's annual contribution to AECL was about \$170 million a year. This will decrease to approximately \$100 million for the fiscal year 1998-99.

29.10 Program Review recommended that the corporation focus on commercial business. As a result, AECL eliminated certain research activities not related to such commercial products as CANDU power reactors. The corporation also began a restructuring program to reduce its costs in order to allow it to continue operating with the reduced annual government funding.

29.11 While Program Review focussed on government funding of AECL, other ongoing issues remain. For each of the six years ended 31 March 1997, the auditors' reports on AECL's financial statements contained reservations of opinion because the corporation had not recorded a liability for its decommissioning and site remediation costs in its financial statements. As of late October 1998, AECL's annual report for the year ended 31 March 1998 had not yet been submitted to the Minister of Natural Resources. Finally, in Appendix D of this Report, we note that the Governor in Council has not approved AECL's five-year corporate plans for over three years. This observation describes developments subsequent to 31 March 1997 relating to some current issues facing AECL, and their implications to the corporation and to Parliament.

Issues

29.12 Ongoing issues between AECL and the government. In early 1998, AECL and the government agreed to deal with a number of outstanding issues in time for implementation in the corporation's 1999-2000 fiscal year.

There are two broad areas under discussion: AECL's commercial CANDU reactor business and the corporation's sites, including related nuclear decommissioning and waste.

29.13 Some specific issues facing AECL include the following:

- **The corporation needs a clear decision from the government on the future of Whiteshell Laboratories in order to complete implementation of Program Review decisions, and to manage its business effectively.** To date, AECL has restructured its operations, including closure of some AECL offices, reduction of other offices, layoffs of staff, and elimination of certain research programs not linked directly to the CANDU business.

Almost two years ago, in December 1996, the government decided to find a private sector operator to commercialize the corporation's Whiteshell operations. Around that time, the government asked AECL to halt any future layoffs at Whiteshell while the commercialization proceeded. However, commercialization efforts failed, and in 1998 the corporation laid off about 250 full-time Whiteshell employees. This left approximately 330 full-time employees at Whiteshell Laboratories as of September 1998. The ultimate future of Whiteshell Laboratories remains uncertain.

- **Roles and responsibilities concerning nuclear waste on AECL's sites need to be clarified.** Until recently, the government funded AECL's nuclear decommissioning and waste activities through annual appropriations. Now these activities are funded by a 10-year agreement whereby AECL will apply the proceeds of heavy water revenue to this purpose. If the 10-year agreement is not extended, funding is to revert to the former annual funding arrangement. AECL currently spends approximately \$15 million annually on waste activities.

In 1997, AECL completed a comprehensive plan for its nuclear facilities and waste. The plan contemplates that the corporation's main research facility at Chalk River, Ontario will remain an active nuclear site for 75 years, and that waste-related activities will continue for 100 years. The corporation estimates that the current discounted cost of all necessary activities is \$400 million. Because of the effect of the time-value of money over the 100-year clean-up period, actual expenditures will be higher than the discounted cost.

As noted previously, one of the areas currently under discussion between the corporation and the government is AECL's sites, including related nuclear decommissioning and waste. These discussions should clarify roles for nuclear waste at AECL's sites in the future.

29.14 Other issues facing AECL. Other issues facing the corporation include the implications for the corporation's cash requirements of a cyclical market for sales of CANDU reactors, and the generally old facilities at Chalk River Laboratories, particularly future closure of AECL's 40-year-old research reactor. This reactor is used for CANDU-related research and other scientific research.

29.15 The Crown corporation accountability framework contemplates annual government approval of AECL's plans, but this has not happened since 1994-95. The corporate plan is one of the key components of the accountability regime established for Crown corporations through the *Financial Administration Act*. It sets out management's and the Board of Directors' direction for the corporation and, through the mechanism for approval, provides for government capability to influence that direction. A summary of approved plans is then provided to Parliament so that all can know the corporation's objectives and its plans for achieving them. Finally, in their accountability regime, Crown corporations report annually to Parliament through their annual reports on the extent to which those objectives have been met.

29.16 AECL has submitted annual operating and capital budgets each year, and these have been approved by the government and tabled in Parliament. However, while AECL has also submitted five-year corporate plans each year, they have not been approved by the Governor in Council since 1994-95. This was also the last year for which a corporate plan summary was tabled in Parliament. There are no other situations where a Crown corporation's corporate plan has not been approved for over three years. In the circumstances, the process contemplated by the

Financial Administration Act for approval and communication of a Crown corporation's strategic direction is not functioning in the case of AECL.

29.17 The lack of an approved corporate plan since 1994-95 also means that the last AECL corporate plan summary tabled in Parliament was almost three years ago, in December 1995, instead of annually as contemplated by the *Financial Administration Act*. AECL is changing rapidly, in response both to Program Review and the commercial marketplace. In this time of change, parliamentarians have not been informed of AECL's plans.

29.18 The relationship between the corporation, government and Parliament is not in keeping with the accountability framework set out in the *Financial Administration Act*. However, the government and AECL continue to discuss the future of the Whiteshell Laboratories, and the separate current discussions between AECL and the government are intended to address many of the other outstanding issues. These initiatives need to be seen through to a timely, successful resolution.

Conclusion

29.19 These and other issues facing AECL require decisions by the government, identification of funding sources, or agreement between AECL and the government on the appropriate course of action. These decisions need to be reflected in an approved corporate plan for AECL, a summary of which would then be tabled in Parliament.

Department of Finance

Assistant Auditor General: Ron Thompson

Principal: Jeff Greenberg

Information for Parliament and Canadians: Transparency and the government's Annual Financial Report

When the government began producing an Annual Financial Report (AFR) almost five years ago, it was responding to a need of both Parliament and the public for information to help them play a more active and effective role in guiding government decision making. Since its introduction, changes to the Annual Financial Report have been kept to a minimum in order to maintain consistency for ease of comparison from one year to the next. Yet events both domestic and international have heightened the need for improved financial reporting by governments and suggested new ways of bringing this about. We believe that it is time to revisit the Annual Financial Report to make it more useful, and we call on the Department of Finance to do so.

Background

29.20 Since the mid-1980s, this Office has been calling for the government to produce an annual financial report to help Parliament and the public play a more active and effective role in guiding government decision making. In 1993, we suggested that such a report contain not only condensed financial statements but also a section containing five indicators that would help to illustrate the state of government finances. In 1994, the government began producing such a report. For the last few years, the Annual Financial Report (AFR) has been published as part of the Minister of Finance's fall Economic and Fiscal Update.

Issue

29.21 The importance and usefulness of financial reporting have taken on considerable prominence in the last few years, both domestically and internationally:

- On the domestic front, the Canadian Institute of Chartered Accountants (CICA) in 1994 initiated a research study on indicators of financial condition for the federal and provincial governments. The study suggested a general set of indicators that governments might consider using to give readers a more complete and understandable picture of financial condition. These indicators were designed to report on a government's sustainability, flexibility and vulnerability. (Definitions of these terms are found in Exhibit 29.1.) The idea was to provide information on not only the state of the government's finances through credible, reliable and understandable financial statements but also on the factors that affect those public finances. This would include key indicators of the Canadian economy, as well as benchmarking Canada's performance against that of other jurisdictions in similar economic and political circumstances.

Exhibit 29.1

Indicators of Government Financial Condition

Sustainability. The degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy.

Flexibility. The degree to which a government can increase its financial resources to respond to rising commitments, by either expanding its revenues or increasing its debt burden.

Vulnerability. The degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside of its control or influence, both domestic and international.

Source: *Indicators of Government Financial Condition*, Canadian Institute of Chartered Accountants, 1997

- At the same time as the release of the first Annual Financial Report, the Minister of Finance began appearing before the House of Commons Finance Committee to seek its input into the Budget process. To accompany that appearance, he also began tabling a fall Economic and Fiscal Update document. Since then, that documentation has gone through a number of changes to try to make it more informative to Canadians. In fact, much of the information the CICA study suggested is already currently available publicly in a variety of documents like the fall Economic and Fiscal Update. The challenge now is to make this important information more readily accessible and more widely used; in other words, to make it more *transparent*.

- The recent report of the Task Force on the Future of the Canadian Financial Services Sector declared, “Disclosure governs what information is provided. Transparency is concerned with the clarity of that information: how understandable it is to the consumer.” We share the Department’s goal of providing ordinary Canadians with simple access to useful information about the government’s financial condition, and believe the Annual Financial Report can and should play an important role in this regard.

- Others beyond Canada’s borders also see the need for better financial information. As part of its emphasis on good governance, the International Monetary Fund has been stressing the need for improved transparency in budgetary operations through its *Code of Good Practices on Fiscal Transparency*. The United Kingdom, too, has moved in this direction with its new Code of Fiscal Responsibility. As Mr. Gordon Brown, Chancellor of the Exchequer in the United Kingdom, reported to the Commonwealth Meeting of Finance Ministers in Ottawa in October 1998:

Greater openness in procedures as well as in the dissemination of information will not only reduce the likelihood of market corrections by revealing potential weaknesses at an earlier stage but will generate a better understanding of the reasoning behind decisions and encourage better decisions and wider support for the policies.

All of these calls for more complete disclosure by national governments are based on the understanding that inadequate official financial information can undermine sound economic performance.

- And finally, as stated in the chapter of this Report titled Matters of Special Importance:

The recent Asian financial crisis attests to the importance of transparent, fair and complete information on the financial condition of governments. The International Monetary Fund identified lack of transparency as a contributing factor to that crisis. Understandable, timely reporting of useful information contributes to better performance, by supporting informed decision making and exposing the activities of government to the discipline of public scrutiny.

This in no way implies that the Canadian economy or government finances are comparable with the Asian economies. Nevertheless, this concern for transparency has sparked the current Minister of Finance to call for better and more complete reporting by financial institutions internationally. His argument is simply that better and more timely information would reveal potential weaknesses earlier and lead to corrections before crises developed.

Conclusion

29.22 The government’s decision to produce an Annual Financial Report with a condensed set of financial statements accompanied by selected indicators was a major step forward in communicating the government’s financial condition to parliamentarians and Canadians generally. But readership of this important accountability

document has dropped in recent years, even though the need for the type of information it conveys has been heightened. In our view, it is time for the Department of Finance to revisit the form and content of the Annual Financial Report to make it a more useful document. In doing so, the Department might consider ways of linking the document more clearly to the Minister's fall Economic and Fiscal Update, and perhaps streamlining the size and shape of the report to facilitate its access and use by interested Canadians.

Industry Canada and Natural Resources Canada

Assistant Auditor General: Richard Flageole

Principal: Peter Simeoni

Concerns about poor control over computers loaned to employees for home use

Many government departments and agencies lend their employees spare computer equipment for official use at home. In our view, this practice is not being managed properly in the two departments we audited. We are also concerned that this weak control may affect the federal government's contribution to the Computers for Schools program.

Background

29.23 Many departments and agencies allow employees to take home computer equipment for work-related reasons once it is no longer needed at the office. This equipment becomes available for home use when it has been replaced by newer hardware at the office and is not needed to meet any anticipated departmental requirements.

29.24 In the case of Industry Canada, although records are not up-to-date, we estimate that as many as 1,000 of the Department's 4,900 employees have taken computer equipment home; at least 800 employees of Natural Resources Canada have done the same. Although some of these computers are used for approved teleworking arrangements, the vast majority have been provided as a second computer at home, in addition to one at the office, to enhance productivity. While we have not looked at the situation in every federal department and agency, there are indications that the loan of computers is widespread throughout the government.

29.25 Government policy specifies that when these computers are no longer needed to do work at home, they are supposed to be returned to the department and sent to the Computers for Schools program after being declared surplus. Computers for Schools, a partnership formed in 1993 by Industry Canada and Telephone Pioneers, is a program administered by Industry Canada and delivered in co-operation with provincial governments, businesses and volunteer organizations. Computer equipment donated by the private and public sector is collected, refurbished and distributed to schools and libraries across the country for free.

29.26 The inspection and repair of donated equipment take place in regional workshops operated by volunteers from the Telephone Pioneers, a volunteer group of employees and retirees of the telecommunications industry, and other program partners. Support from these companies includes space for warehousing and repair operations and, along with other private sector partners, they assist in many other ways such as shipping equipment to school boards.

29.27 The program challenge is to place 250,000 used and refurbished computers in schools and libraries across the country by the end of March 2001. According to the program's figures, a total of 78,000 computers since 1996 have been donated by the federal and provincial governments and the private sector and shipped to schools as of August 1998. Program managers advise that Industry Canada is the fifth largest donor of computers among federal departments. The program expects to ship an increasing number of computers to schools in the next two years in order to achieve its target.

29.28 An important effect of the program, beyond the obvious benefits of increasing the ratio of computers to students in our schools, is that equipment that no longer has value for governments and businesses gains a second life in a classroom.

Issues

29.29 We focussed our audit on whether the federal government had adequate policies and practices for controlling the loan of computer equipment to employees. We also considered whether any weaknesses we found in policies and practices affected the government's contribution to the Computers for Schools program.

29.30 We examined the relevant policies set by the Treasury Board Secretariat on materiel management as well as the computer equipment management policies and practices of two departments: Industry Canada and Natural Resources Canada.

Policy framework

29.31 Government-wide policies for loan of equipment. The Treasury Board's *Materiel Management Policy* sets out the management framework for all kinds of government-owned equipment, including computer systems. Under the policy, equipment can be taken home for work-related duties only. The policy states that the materiel is always Crown property; when it is no longer being used for work-related duties, managers are responsible for its recovery.

29.32 Once recovered, equipment that is no longer needed or is not cost-effective to repair can be declared surplus. Normally, surplus materiel is auctioned off. However, the policy requires departments to donate surplus computer equipment to the Computers for Schools program.

29.33 Departmental policies for loan of equipment. We looked at the policies of two departments: Industry Canada and Natural Resources Canada. Both departments advised us that by allowing employees to take home spare computers, managers have found an economical way to increase productivity.

29.34 According to Industry Canada's policy, computer equipment no longer required by a responsibility centre can be borrowed for specific work-related activities at home. The Department also lends equipment to help employees improve their computer proficiency. Employees must have the loan approved by the designated managers who are responsible for ensuring that loans of equipment are justified. All microcomputer equipment in employees' homes is supposed to be recorded in the department's central asset management information system.

29.35 Natural Resources Canada does not have formal departmental policy or procedures for the loan of computer equipment to employees, and there is no corporate inventory. The Department is organized into five sectors, with each one managing its own assets. Some sectors have a policy on loaning microcomputers, others do not. Where policies exist, they are similar to those of Industry Canada in that employees are allowed to take computer equipment home for work-related or training purposes. One sector has a list of borrowed equipment; the other four expect individual managers to keep track of computer loans.

29.36 In our view, Industry Canada has clear and simple policies for managing this equipment across the Department, while Natural Resources Canada does not. Natural Resources Canada is in the process of developing an asset management policy that will include microcomputers.

Weak departmental control practices

29.37 Approval of loans. We examined whether the loan of computer equipment was authorized and justified. In Industry Canada, we found many examples where loans had been approved by unauthorized individuals. In most cases we examined, the reason given for the loan was no more specific than it was "work-related"; in some cases, no reason at all was given.

29.38 At Natural Resources Canada, individual managers are expected to develop their own controls for computers; there is no departmental system. We looked at the practices of two managers, and found that, while their procedures were different, loans were approved by the appropriate person. Neither manager required that the reason for the loan be explained on file.

29.39 Inadequate records. We are also concerned that both departments have inadequate records of computer equipment on loan. Our review of Industry Canada's records indicates that they are out-of-date. We found that the Department does not have adequate information on how much equipment is loaned out to employees and how much has been returned. The Department was implementing a new asset management system, planning a physical count of all equipment and piloting tighter control procedures at the time of our audit.

29.40 Some sectors within Natural Resources Canada were able to provide us with lists of loaned equipment; others have no single list but have loan approvals on file. However, without a reasonably current inventory of all computer equipment against which to compare, we were unable to determine whether these lists, together with the approvals on file, provided a complete record of equipment on loan. The Department was also implementing a new asset management system at the time of our audit.

29.41 As a result, we are concerned that this may lead to situations where employees:

- are borrowing equipment for other than work-related reasons;
- have more than one computer from the department at home;
- do not return equipment when leaving or transferring within the public service; and
- return equipment, but it is not recorded in the inventory system.

29.42 Related issues. Another issue that departments need to consider in managing computers on loan to employees is Internet access. First, both departments allow employees to access the Internet from home through departmental networks using either loaned computers or their own. We found that Industry Canada has an Internet use policy and reviews the Internet activity of employees for inappropriate use. However, Natural Resources Canada does not actively monitor Internet use either from the office or home. In our view, it is important to review the risk of not monitoring Internet activity for inappropriate use. Natural Resources Canada is in the process of developing an Internet policy on usage, monitoring and reporting.

Impact on Computers for Schools program

29.43 The weaknesses we found in departmental practices may affect the federal contribution to the Computers for Schools program. In our view, managers are not encouraged to recognize the considerable value that computer equipment still has after it is surplus to government needs. While most kinds of equipment have outlived their usefulness by the time they are declared surplus, the Computers for Schools program breathes new life into computer equipment. Even older computers have value because they can be used by schools for applications requiring less computing power, such as word processing, thereby freeing up more powerful equipment for other uses. But because these computers are treated like all other materiel, managers are encouraged to find increasingly marginal uses for them until they have no use at all.

29.44 Weak control over microcomputers may have resulted in fewer useful computers being donated by the federal government to the program. We found that the federal government has donated almost 80,000 computers in total to date. However, one third were found to be missing key components such as the processor, memory or the hard drive. The program was able to salvage many of these computers, but the rest were of no use. In the case of the two departments we audited, we were unable to determine why components were removed from some of the computers donated to the program. Departmental officials explained that some components were probably retained

for the purposes of repairing similar computers, but they do not keep records. In our view, and in the view of the departments we audited, the removal of computer components should be for valid reasons.

Conclusion

29.45 We believe that there is a need to establish consistency and minimum control requirements within and across government departments and agencies for the loan of computer equipment to employees. It is important that:

- computer equipment be loaned to employees only for truly work-related reasons;
- responsible managers always approve the long-term removal of government property from departmental premises;
- equipment not be loaned to employees indefinitely;
- equipment be returned when it is no longer being used for work-related activities;
- departments and agencies consider setting recall dates coinciding with the nature of the work being done at home; and
- control over computers at homes of employees be improved and the inventory records kept up-to-date.

29.46 Finally, loaning computer equipment to employees indefinitely without a clear work-related reason could encourage them to treat government property as their own. Controls should be established to strike a balance between the cost of control and the risk of misuse, while also considering the benefits of making these assets available to employees for work at home and giving them a second life in schools.

Public Works and Government Services Canada

Assistant Auditor General: Shahid Minto

Director: Joe Martire

There is an urgent need for an updated long-term comprehensive plan to restore and renovate the Parliamentary Precinct and for a non-partisan advisory body to assist Parliament and the government by providing advice on the plan and the priorities of work

Canada's Parliament buildings are undergoing an extensive restoration and renovation program. It is widely acknowledged that the buildings are in need of repair and restoration.

Roles, responsibility and accountability for actual and planned expenditures totalling hundreds of millions of dollars continue to be complex and unclear. No one organization has overall responsibility for the Parliamentary Precinct. The Senate and the House of Commons should reconsider our 1992 recommendation to establish a Parliament Buildings Council.

Despite assurances to the Treasury Board over the last three years that it would submit a revised long-term plan, Public Works and Government Services Canada (Public Works) has not yet sought approval of an updated comprehensive long-term plan for the Parliamentary Precinct. Because future projects are inextricably linked, there is a pressing need for an approved long-term strategic plan that articulates the program's objectives, scope and cost.

Background

29.47 Exhibit 29.2 defines the Parliamentary Precinct and Exhibit 29.3 summarizes the respective roles and responsibilities of key organizations involved in the Precinct.

Exhibit 29.2 is not available, see the Report.

Exhibit 29.3

Roles and Responsibilities of Key Organizations Involved in the Precinct

- The Minister of Public Works and Government Services is the official custodian of the buildings and is charged with responsibility for their care and upkeep, specified in law. However, there is another relevant constitutional principle - that the two Houses are each responsible for their internal affairs. The challenge, therefore, is to balance the Minister's legislative authority with Parliament's constitutional and legislative authority for its own affairs.
- In the House of Commons, accommodation matters are the ultimate responsibility of the Board of Internal Economy. The Board is chaired by the Speaker of the House of Commons and includes representation from all official parties.
- At the Senate, responsibility for accommodation matters rests ultimately with the full Senate. The Committee on Internal Economy is usually delegated to examine and recommend action on accommodation matters.
- Other departments and agencies add to the complexity of the situation:
 - The Treasury Board Secretariat is responsible for providing a policy framework for management of all real property and advises the Treasury Board on its decisions related to long-term planning and funding for the Precinct.
 - The National Capital Commission has responsibility for outdoor visitor programming, services and events, and for design and planning approvals within the Precinct. It is also responsible for grounds management.

- Parks Canada, through the Federal Heritage Building Review Office, is involved in heritage aspects of the decisions to improve the buildings and land on the Precinct.

In addition, the RCMP, the City of Ottawa, the Regional Municipality of Ottawa-Carleton and other groups may be involved in addressing specific issues.

Source: Public Works and Government Services Canada

29.48 In our December 1992 Report to the Senate and the House of Commons on Matters of Joint Interest, we made several observations and recommendations aimed at assisting Parliament and the government to make decisions about the maintenance and improvement of the Parliamentary Precinct buildings. Specifically, the report noted that:

- roles and responsibilities for the Parliamentary Precinct were complex and needed to be clarified and rationalized;
- progress on making and implementing plans for renovations and capital improvements for the Parliamentary Precinct had been slow; and
- better reporting of costs was needed.

29.49 We recommended the establishment of a small, voluntary, non-partisan advisory body, a Parliament Buildings Council, to provide outside advice on priorities of work required on Parliament Hill and to improve the quality of information available. Our detailed recommendations concerning the Council's objectives, mode of operations, organization and membership are presented on pages 49 and 50 of the Annex to the 1992 Report to the Senate and the House of Commons on Matters of Joint Interest.

29.50 According to Public Works documents, the Department spent about \$183.5 million on asset and accommodation improvements during the period 1992-93 to 1997-98. It also spent an average of about \$25.6 million annually, including payments in lieu of taxes, to operate and maintain the Parliamentary Precinct.

29.51 Major projects completed since 1992 include conservation of the Peace Tower, rehabilitation of the 1910 wing of the East Block, repair of the south façade of the Centre Block, masonry repairs throughout the Precinct, and construction of the Centre Block two-storey underground utility and storage facility.

Issues

29.52 Updating the long-term plan. The need for an approved comprehensive plan to restore and renovate the buildings and grounds of the Parliamentary Precinct and to address Parliament's long-term accommodation requirements has long been recognized. The chronology of key events leading to the development in 1992 of a long-term construction program (LTCP) is outlined in Exhibit 29.4.

Exhibit 29.4

Key Events Leading to the Development of a Long-Term Construction Program for the Parliamentary Precinct

The Abbott Commission report of 1976 made a number of recommendations regarding the amount and type of accommodation and facilities that Parliament required to operate effectively in the future.

A consultants report in 1987, sponsored jointly by the National Capital Commission and Public Works, included recommendations that provided a preliminary basis for an accommodation plan in the Parliamentary Precinct, as well as both urban design guidelines and a demonstration plan for long-term development. The principles, urban design guidelines, and demonstration plan/concept of the Demonstration Plan were subsequently approved by the National Capital Commission.

In September 1988, Cabinet approved a Real Property Capital Investment Strategy for the National Capital Region including a Parliamentary Precinct construction program. Cabinet directed the Minister of Public Works, in consultation with government leaders in the House of Commons and Senate, to develop a government position on the Precinct development plan for approval by the Treasury Board and Cabinet.

In September 1992, the Treasury Board approved in principle Public Works' long-term construction program for the Parliamentary Precinct. Public Works estimated the program's total cost at \$483 million, comprised of \$265 million to address health and safety issues and ensure the essential operations of Parliament and \$218 million to address all other accommodation needs. Due to fiscal constraints, \$265 million was approved over an 11-year period.

Source: Public Works and Government Services Canada

29.53 According to Public Works officials, the 1992 long-term construction program was developed with early input of the accommodation and functional requirements of the House of Commons, the Senate and the Library of Parliament. Furthermore, the physical condition of the assets within the Precinct was much worse than preliminary investigations indicated. In addition, accommodation and functional requirements have changed over this period. Security requirements are being re-considered and information technology requirements are adding increasing pressures.

29.54 In June 1995, Public Works informed the Treasury Board that it would submit an updated long-term plan at an appropriate time. In March 1997, Public Works informed Treasury Board that it would be submitting, later that year, a revised LTCP identifying overall program cash flows and funding requirements to fiscal year 2010-11. The plan would also include additional funding requirements for furniture, fixtures and equipment for all future projects. A preliminary profile of the revised LTCP noted that the cost of major capital projects (over \$1 million) would total approximately \$750 million from 1992-93 to 2010-11.

29.55 On 23 September 1998, the Minister of Public Works and Government Services reported that "*the currently forecast cost to complete approved restoration and renovation projects is \$423,324,102.*" The report, however, was not intended to provide the estimated costs to fully restore and renovate the Parliamentary Precinct and to fully address the accommodation, security and information technology needs of parliamentarians, staff, visitors and the media. According to Public Works working documentation, the cost both of approved projects and of those yet to be approved could total about \$1.4 billion over the period 1992-93 to 2012-13.

29.56 Requirements of the plan. Public Works policies and good building management practices require that asset management plans be prepared and kept up-to-date for each asset. The plans should identify the life cycle costs of operating, maintaining and, in some cases, preserving the asset. We noted that these plans have not been fully prepared for all Parliamentary Precinct buildings. Public Works officials informed us that there are additional reports on specific aspects of each building and that this information needs to be consolidated into the updated long-term plan.

29.57 Because future projects are interrelated, there is a pressing need for an updated and comprehensive long-term plan for the Parliamentary Precinct. The approved plan would facilitate a well-ordered, logical development of the Parliamentary Precinct. For example, although Public Works has secured Treasury Board approval to renovate the West Block, the budget did not account for the potential changes to clients' requirements for committee rooms that will be decommissioned during the West Block renovations. According to Public Works officials, a decision is also needed, for security reasons, on the location and design of a loading dock for the West Block before the building can be occupied. In 1996, Public Works acquired the United States Embassy building, which may be added to the Parliamentary Precinct. However, the building's future use has not yet been determined.

29.58 The plan also needs to address issues such as space standards for members of Parliament, ministers, senators, Parliamentary Precinct staff, and the media; their proximity to the Hill; and other related issues such as security, parking and visitor services. Without an updated long-term plan, resources cannot be allocated and

managed in a cost-effective manner. The approved plan would establish a baseline for measuring and assessing the program's progress.

29.59 Roles and responsibilities. We noted that roles and responsibilities continue to be complex and unclear and we are concerned that our 1992 recommendation to establish a Parliament Buildings Council has not yet been implemented.

29.60 Sound project management principles require that roles and responsibilities of key participants be clearly defined and documented, normally in a memorandum of understanding or a project charter. We noted that these formal mechanisms had not been in place for projects completed to date. We were informed that although there is extensive consultation regarding project requirements, the House of Commons and the Senate generally do not formally "sign off" their statements of requirements.

29.61 Public Works officials also informed us that it is complex to co-ordinate and reach agreement on common requirements for the House of Commons, the Library of Parliament, the Senate and their staffs. They believe that potential cost savings may be realized through better co-ordination of requirements and sharing of facilities and systems. A first step has been taken with the Parliamentary Precinct Information Technology Program Charter signed in December 1997 by Public Works, the Senate, Library of Parliament and the House of Commons. Public Works officials believe that further savings may be achievable through a co-ordinated overall study of such things as the House of Commons and Senate committee room requirements. Exhibit 29.5 illustrates a case of the difficulty in co-ordinating and reaching agreement on requirements.

Exhibit 29.5

Case Study - Cafeteria in the 1910 Wing of the East Block

The 1990 statement of user requirements identified the need for a cafeteria in the 1910 Wing of the East Block.

During project planning, officials of the House of Commons and the Senate took part in consultations with officials of Public Works.

Construction of the cafeteria commenced in December 1995.

At its meeting of 11 June 1996, the Board of Internal Economy of the House of Commons questioned the inclusion of a cafeteria because it was closing other cafeterias on the Hill and indicated its intention to raise the issue with both the Minister and the Senate.

In November 1996, the Senate informed Public Works that the original requirement for a cafeteria had changed, and that the space was to be reallocated as a committee room.

In May 1997, a consultant engaged by Public Works reported that the existing cafeteria could be transformed into a limited-use conference room but the space allocation did not meet committee room requirements.

According to Public Works officials, except for the deletion of minor cooking equipment, it was determined that it would not be cost-effective to implement the Senate's request to reallocate the space from a cafeteria to a committee room. Therefore, despite the requests from the Senate, Public Works proceeded with the original project.

The cafeteria was completed in July 1997 at an estimated construction cost of \$612,000. It is being used for purposes other than intended.

Conclusion

29.62 Work on the Parliamentary Precinct is considered necessary to preserve and maintain one of Canada's most treasured national symbols and to take into account Parliament's accommodation, security and information technology requirements into the 21st century. In our view, current arrangements and management practices need strengthening if these important national heritage assets are to be managed and preserved with due regard to long-

term economy and efficiency. For the restoration and renovation program to be a success, there must be general consensus about the program's objectives, scope and cost among all the key stakeholders.

29.63 This is an opportune time to update the long-term plan to restore and renovate the Parliamentary Precinct. The comprehensive long-term plan needs to include guiding principles to address the accommodation, security and information technology requirements of parliamentarians, staff, visitors and the media. We reaffirm our view that a non-partisan co-ordinating Council is necessary to review the plan for the development of the Parliamentary Precinct. The appointments to the Council should be made in a manner that is transparent, equitable, and enhances the independence of the body. For example, it could be composed of eminent Canadians, with input from all parties. It is important that such a council be established sooner rather than later and that it review the plan before it is submitted to the Treasury Board.

29.64 We plan to monitor the work on the Parliamentary Precinct and report to Parliament, as appropriate.

***Public Works and Government Services Canada response:** The Parliament Buildings are a unique heritage resource, as well as an important national symbol of Canada. These buildings are also the centre of parliamentary operations and a venue for celebration.*

A long-term capital plan for the Parliamentary Precinct has been in place since 1992. The plan included many projects now completed such as the conservation of the Peace Tower, the renovation of the 1910 Wing of the East Block, the construction of the Centre Block Underground Services facility, urgent masonry repairs, etc. The current 1992 long-term plan covers the period until 2003-2004.

Public Works and Government Services Canada is currently developing a further plan for the period beyond 2004 until 2007. The overall plan will be updated regularly in accordance with a long-term planning framework that will provide a forum for stakeholders (Senate, Library of Parliament, House of Commons, National Capital Commission, Federal Heritage Building Review Office, and Treasury Board) to provide their input into the development plans for the Parliamentary Precinct.

Revenue Canada

Assistant Auditor General: Shahid Minto
Principal: Barry Elkin

Fairness in the Canadian income tax system

Fairness in treating people and applying the law is the cornerstone of the administration of the Canadian income tax system. The principle of fairness is enshrined in Revenue Canada values and objectives. One of these objectives is to ensure the fair and timely assessment, collection and, where appropriate, refund of all taxes, duties and other relevant charges and levies.

During the course of our work, we came across two situations that raise concerns about the fairness of the Canadian income tax system. Although these two situations do not involve significant tax leakage, they do affect certain individuals in a significant manner. We believe that over time they have the potential to erode the confidence of taxpayers in the fairness of the Canadian income tax system.

Deficiency in the matching program for personal income tax returns

Taxpayers who understate the amount of income tax deducted at source on their income tax returns end up paying more than their fair share of income tax. This is because Revenue Canada's matching program for personal income tax returns is not designed to detect this type of taxpayer error.

Background

29.65 Revenue Canada has a processing program that compares information reported by taxpayers on their personal income tax returns with information obtained from third parties. The program is designed to identify and correct situations where taxpayers have overstated the amount of tax deducted at source on their income tax returns.

29.66 To understand the issue, we examined a sample of 1996 income tax returns that included Old Age Security (OAS) pension income on which tax had been deducted. In about four percent of the cases reviewed, we found that taxpayers had understated the taxes deducted at source on their OAS pension income on their income tax returns. The average amount of unreported tax deducted at source was \$1,865. In all these cases, Revenue Canada's processing program did not detect or correct these taxpayer errors and the taxpayers ended up paying more than their fair share of taxes.

Issue

29.67 Revenue Canada's processing program is not designed or set up to identify situations where taxpayers have understated the amount of tax deducted at source on their income tax returns. Consequently, taxpayers that have understated the amount of their tax deducted at source will end up overpaying their personal income taxes.

Conclusion

29.68 Taxpayers may be paying more than their fair share of income tax because of a deficiency in Revenue Canada's processing program for personal income tax returns. We believe there is a need for Revenue Canada to correct this deficiency. This would increase the fairness and equity of the Canadian tax system.

***Department's response:** Revenue Canada places a very high priority on the fairness of the Canadian taxation system. The Department is committed to seeing that Canadians pay their fair share of income tax, no more and no less. Revenue Canada's "Fairness Initiative", which was launched by the Minister in March of 1998 and involves a wide range of consultations with action plans, is one method of ensuring that we fulfil this commitment.*

For the specific issue cited, 95 percent of Old Age Security (OAS) recipients do not have tax deducted at source. For the remaining five percent of cases, where tax is deducted, the Department has procedures in place to detect situations when a taxpayer has neglected to report both OAS income and taxes deducted. We acknowledge that a small percentage of understated tax deductions currently go undetected. The Department will place a priority on finding a solution to this problem through better training of volunteers (who assist seniors in preparing their income tax returns), general education, and system improvements. The Department is confident that these actions, in conjunction with our continual improvement processes, will address this deficiency.

Transfer of pension funds outside Canada without withholding taxes

Public service employees' pension funds can be transferred out of Canada, on a tax-free basis, through a reciprocal transfer agreement between the federal government and a foreign employer. This treats certain taxpayers more favourably than other taxpayers that must pay tax when transferring their pension funds outside Canada.

Background

29.69 Public Service employees who accept a permanent position with a particular foreign employer may transfer their pension credits through a reciprocal transfer agreement to the new employee's pension plan, if it is registered for purposes of the *Income Tax Act*. The funds can be transferred on a tax-free basis.

29.70 Reciprocal transfer agreements are agreements between the Government of Canada and other employers whereby employees may have their pension plan contributions, plus the matching employer contributions and interest in respect of immediately prior service with one employer, transferred either from the federal government to another employer or vice versa. The purpose of these agreements is to facilitate the mobility of persons between the Government of Canada and other employers.

29.71 In 1991, Pension Reform was introduced and income tax rules for registered pension plans were changed. All pension plans were required to comply with the new rules in order to maintain their registered status.

29.72 In 1995, the Treasury Board Secretariat notified international government-sponsored organizations that it would no longer recognize the reciprocal transfer agreement if the organizations' pension plans were not registered with Revenue Canada. As many organizations did not wish to amend their plans, the Secretariat considered their agreements as no longer valid and notified the organizations of its decision. However, as a result of a reciprocal agreement with one of the organizations, we noted that pension funds totalling \$500,000 were transferred out of Canada by public servants over three years without the normal withholding tax. The Secretariat advised us that it kept the agreement active because it had received information suggesting the foreign plan was still registered with Revenue Canada.

Issue

29.73 Our concern is that funds in a Canadian registered pension plan can be transferred out of Canada on a tax-free basis to a foreign pension that is registered for purposes of the *Income Tax Act*. Canada and the provinces absorbed a reduction in their tax revenues when contributions were made to the Canadian plan. However, they will not necessarily receive any tax when the pension benefits earned in Canada are withdrawn from the foreign-based plan.

29.74 Pension benefits paid to a non-resident by a Canadian registered pension plan are subject to Canadian withholding tax. However, the current agreement makes it possible to transfer funds from a registered Canadian pension plan to a foreign pension plan and avoid Canadian withholding tax. We are concerned that the registration of foreign plans may be used in tax schemes designed to transfer pension funds out of the country on a tax-free basis.

Conclusion

29.75 Certain taxpayers have been allowed to transfer their pension funds out of Canada on a tax-free basis. As a result, these taxpayers are treated more favourably than those who must pay tax when transferring their pension funds out of Canada. This is contrary to the fairness principles of our self-assessment tax system. It is not clear if Parliament intended this to happen.

Department's response: The objective of reciprocal transfer agreements is to facilitate the movement of employees' service from one registered pension plan to another. Such agreements are common in both private and public sector registered pension plans.

The plan in question is one of five foreign plans that were registered prior to the 1992 pension reform. In 1992, new rules restricting the registration of foreign plans were introduced as part of pension reform. These new rules called into question the registered status of these plans. As it was not until June 1996 that regulations were passed to deal with Canadians participating in unregistered foreign plans, Revenue Canada waited for the passage of the 1996 regulations before examining the registered status of these plans.

At this time, Revenue Canada is taking steps to ensure that the rules are applied uniformly to all foreign plans. If the plan is to maintain its registered status under the new rules, one of the registration requirements is that funds must be held in Canada.

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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 <i>Public Service Employment Act</i> .
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 <i>Public Service Employment Act</i> , 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 <i>Public Service Employment Act</i> , 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 <i>Financial Administration Act</i> 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 <i>Financial Administration Act</i> 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 allotments	20. The provisions of the <i>Financial Administration Act</i> with respect to the division 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

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 <p style="margin-left: 40px;">(a) information and explanations, and</p> <p style="margin-left: 40px;">(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries</p> <p>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.</p>
Idem	(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall <p style="margin-left: 40px;">(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</p>

(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-
owned subsidiaries**

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister 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	<p>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.</p>
Reference to committee	<p>(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.</p>
Form and content	<p>(3) The annual report of a parent Crown corporation shall include</p> <p>(a) the financial statements of the corporation referred to in section 131,</p> <p>(b) the annual auditor's report referred to in subsection 132(1),</p> <p>(c) a statement on the extent to which the corporation has met its objectives for the financial year,</p> <p>(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</p> <p>(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> <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	<p>(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.</p>
Annual consolidated report	<p>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.</p>
Reference to committee	<p>(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.</p>
Contents	<p>(3) The annual consolidated report referred to in subsection (1) shall include</p> <p>(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;</p> <p>(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and</p>

(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

Thursday, 27 November 1997

The Standing Committee on Public Accounts has the honour to present its FIRST REPORT

In accordance with Standing Order 108(3)(e), the Committee considered Reports of the Committee presented to the House during the last few months of the Thirty-fifth Parliament and the Committee agreed to request that the Government provide to the Committee comprehensive responses, in accordance with the provisions of Standing Order 109, to the following Reports of the Committee:

- the Fourth Report (*Revenue Canada – Combatting Income Tax Avoidance*), presented on February 10, 1997;
- the Fifth Report (*Service Quality*) presented on April 7, 1997;
- the Sixth Report (*Canada Infrastructure Works Program – Lessons Learned*) presented on April 14, 1997;
- the Seventh Report (*Materiel Management in the Federal Government*) presented on April 15, 1997; and
- the Ninth Report (*Human Resources Development Canada – Canada Pension Plan: Disability*) presented on April 23, 1997.

A copy of the relevant Minutes of Proceedings (*Meeting No. 10*) and a copy of the above-mentioned Reports are tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 27 November 1997

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SECOND REPORT

The Standing Committee on Public Accounts has considered Chapter 12 of the April and October 1997 Report of the Auditor General of Canada (Information Technology: Preparedness for Year 2000) and the Committee has agreed to the following report:

Introduction

As the year 2000 approaches, governments, the private sector, and individuals are faced with potential computer and information systems malfunctions that may have serious consequences. These malfunctions will result if systems are either not replaced or repaired before 2000. Solving the problem, which is a global one, will be labour- and time-intensive, and the estimated costs are enormous. The potential costs of failing to take timely, effective action may be even higher. This issue is commonly referred to as the Year 2000 challenge.

In his October 1997 Report, the Auditor General of Canada informed Parliament that the rate of progress achieved by the federal government in preparing its systems for 2000 has generally been slow. He cited a government estimate that the repair and replacement process will cost \$1 billion and indicated that unless urgent and aggressive action is taken, government systems will not be converted in time. The consequences, he warned, could be severe.

Based on the information contained in the Auditor General's Report, the size of estimated cost of solving the problem, and the urgent action required to avoid costly systems failures, the Committee assigned priority to investigating this issue. Accordingly, the Committee met with the Auditor General of Canada, Mr. Denis Desautels, and Mr. René Guindon (Visiting Assistant Deputy Minister, Year 2000 Project Office) and Mr. Paul Rummell (Chief Information Officer) of the Treasury Board Secretariat on 28 October 1997.

Observations and Recommendations

During its meeting with witnesses, the Committee learned that although progress had been made since the audit was completed in March 1997, the overall prognosis is still not good. In his opening statement to the Committee, the Auditor General summarized his conclusion on completion of his audit: "the rate of progress has generally been slow and ... the residual risks for systems errors and failure ... remain high." Despite work by the Treasury Board Secretariat, and departments and agencies, the Auditor General told the Committee that he remained

Concerned that continuous delivery of major government programs and essential services into the 21st century remains at risk. The potential consequences for the government could be manifested as health and safety concerns, financial implications, disruption to essential services for the public or legal ramifications.

Under questioning from the Committee, Mr. Desautels asserted that the assessment made by his Office in April 1997 continues to be “largely representative of the challenges ahead,” and that “at this point remain very large, very serious.”

For their part, the witnesses from Treasury Board Secretariat pointed out that progress had been made since the audit’s completion. Although they carefully avoiding giving any guarantees that all systems would be repaired or replaced by 1 January 2000, they expressed confidence that the government could meet the Year 2000 challenge. They readily acknowledged the size of this challenge and that much still remains to be done.

The Committee recognizes the progress that has been made and wishes to acknowledge the work done by departments and the Treasury Board Secretariat. Nevertheless, the Committee is concerned that despite efforts to date, government systems — particularly in key areas — may not be fully replaced or repaired in time. This concern is heightened by the Auditor General’s observation, in his report, that in the past, “only 16% of [the federal government’s information] systems were delivered on time and within budget.”

The concerns of the Committee fall under six categories: accurate costing and the availability of resources to address the issue; contingency plans; service to the public; integrity of data banks; accountability and the role of Treasury Board Secretariat; and, information for Parliament. Accordingly, the Committee makes the following observations and recommendations.

Estimated Costs and the Availability of Resources

In his Report, the Auditor General indicated that according to its own estimate, the cost to the federal government of meeting this challenge could be approximately \$1 billion. Treasury Board Secretariat witnesses confirmed this estimate, which they asserted, is still accurate, more than five months after it was first made. They acknowledged, however, that costing in many departments is still incomplete. According to the Auditor General, the \$1 billion figure

Is a global estimate arrived at by making some rough calculations ... it’s not a department by department estimate of where they are at and how much each [department] is going to need to carry this out,...

As Mr. Desautels stated (with the agreement of TBS witnesses) the estimate — although the best one available — is a “soft” one. It is thus clear to the Committee that, at this stage, no one has a definitive estimate of the total costs involved in solving the Year 2000 challenge.

Treasury Board officials did not know how much of this estimated total had been spent to date. In further testimony, they indicated that departmental spending on the problem came mostly out of existing budgets. Treasury Board Secretariat, they added, is now in the process of determining whether or not costs in addition to existing budgets will be involved.

In his report, the Auditor General indicates that Treasury Board Secretariat plans called for updates of departmental progress in September 1997 and January 1998. Yet when pressed for details on progress to date, Secretariat witnesses repeatedly told the Committee that they would not have answers until December 1997. Nevertheless, they told the Committee on several occasions that much progress had been made since the Auditor General had completed his audit.

Perhaps the lack of solid information also prevented Secretariat witnesses from being more precise about staffing plans. According to their testimony, there are approximately 8,000 government employees who now work in the information technology area. Government has announced plans to hire an additional 2000 and to increase levels of pay. When asked, however, whether those now working in this area would be taken away from current assignments in order to solve the problem, the witnesses did not comment.

The absence of a more accurate estimate on total costs combined with uncertainty over the allocation of human resources poses two problems: whether sufficient resources will be devoted to correct the problem; and, if not, whether technology installation and upgrade projects now underway will have to be cancelled or postponed. As witnesses pointed out, costs are now being covered out of existing budgets. This sets up a tension between the need to solve the Year 2000 problem and the need to complete other technology installation and upgrade projects.

The Committee fully expects that a firmer estimate, based on a department by department analysis, will help clarify some of these issues. In the meantime, it recommends:

That the government, as it responds to the year 2000 challenge, identify critical technology installation and upgrade projects now under development and take steps to ensure that these projects are maintained.

The Committee is anxious that the Chief Information Officer Branch within Treasury Board Secretariat and its Year 2000 Project Office has the necessary assistance. As the Auditor General stated, the CIO's office "will need a lot of support" in order to meet this enormous challenge successfully. The Committee is concerned with achieving solutions and therefore recommends:

That Treasury Board and Treasury Board Secretariat give the Chief Information Officer Branch the full support and assistance necessary to resolve the Year 2000 challenge successfully.

As 2000 draws closer, competition for the services of individuals with the skills needed to fix the problem will intensify. The Committee heard evidence that competition for skilled individuals is already occurring. The Committee is aware that the CIO Branch has developed an action plan for managing human resources in the information technology community that addresses Year 2000 issues. There is a need, however, for a contingency plan in case this action plan is insufficient. The Committee therefore recommends:

That Treasury Board Secretariat recognize the growing competition for the services of individuals with the skills needed to resolve the Year 2000 challenge and draw up an internal contingency staffing plan.

Another area of concern involves the need for contingency plans. In his report, the Auditor General advised Parliament that at the time of his audit "none of the nine [audited] departments ...[had] started preparing substantive contingency plans for their systems." (12.83) He also reported that only three of 50 departments and agencies that responded to a survey replied that they had developed contingency plans; none of them supplied a copy.

In answer to questions put to them, Secretariat witnesses told the Committee that the development of contingency plans "is not priority one." Instead, the focus is on fixing the problem. In his Report, however, the Auditor General advises that many departments and agencies will be unable to test their systems that have been repaired or replaced before 01 January 2000. To the Committee, this means that these systems will be exposed to the

risk of failure while they are operational. This in turn means that alternative methods of supporting the delivery of essential programs should be available in case they are needed.

The Committee believes all departments that deliver critical programs that are exposed to risk must have contingency plans in place in case the support technologies for them fail. The Committee therefore strongly recommends:

That Treasury Board Secretariat ensure that all departments and agencies that deliver programs that are exposed to risk and that directly affect the health, security, and economic well-being of Canadians, have contingency plans proportional to the level of risks involved in place to sustain those programs in the event of systems failure on 1 January 2000.

The Committee is also concerned that in the effort to identify priorities and develop contingencies, a focus on the delivery of service to citizens will not receive sufficient attention. When asked about this issue, the Chief Information Officer of Treasury Board Secretariat told the Committee:

I cannot [un]equivocally say that customer service, meeting the needs of the individual Canadian citizen, the businesses, the small businesses, the large businesses of Canada, is the central focus of our mission..

The Committee believes that this factor needs to be given greater prominence in the Year 2000 project, and therefore recommends:

That the Chief Information Officer Branch and the Year 2000 Project Office attach a priority to quality of service delivery to citizens and that it communicate this priority to all government departments and agencies.

Accountability and the Role of Treasury Board Secretariat

Accountability is an issue that is of greatest importance to this Committee. In terms of taking effective action and achieving satisfactory results, there is great merit in having one department, and one individual within that department capable of taking the lead responsibility for solving problems. Knowing who holds the responsibility means knowing who is in a position to make decisions and to act on them. It means knowing who is in charge.

When the Committee asked questions in this area, it was told that departments are responsible for ensuring that their systems are adequately prepared for 2000. Treasury Board Secretariat, for its part, is responsible for providing guidance and leadership on this challenge throughout government, particularly in the search for solutions to common problems.

Under normal circumstances, this may be an appropriate division of responsibility. In this instance, however, in the opinion of the Committee, more assertive action by Treasury Board Secretariat will be necessary. In his Report, the Auditor General calls on the Secretariat to attach priority to identifying and monitoring the government's most critical systems. He also calls for strategic intervention in the event that repair efforts in critical areas are falling behind. This will require the Secretariat to go beyond its usual role as a leader and facilitator and intervene strategically where necessary.

In light of these considerations, and in light of the urgency attached to the Year 2000 challenge, the Committee therefore recommends:

That Treasury Board Secretariat assume full responsibility and authority for resolving the Year 2000 problem and ensure that the lines of its authority in this regard are clearly understood by all departments and agencies.

It is also important that one person within the Secretariat assume the responsibility for meeting this challenge. Yet there was some ambiguity in the testimony given by Secretariat officials. In the written version of his opening statement, Mr. René Guindon, the Visiting Assistant Deputy Minister, Treasury Board Secretariat Year 2000 Project Office, indicated that he has the “responsibility for the Year 2000 issue within CIO Branch of Treasury Board Secretariat.” During testimony, however, Mr. Paul Rummell, the Chief Information Officer, told the Committee that he carries “the primary sponsorship for this project.” To clear up any confusion, the Committee recommends:

That Treasury Board Secretariat clearly identifies whom, within the Secretariat, holds the principal responsibility for the Year 2000 project, as quickly as possible.

In his Report, the Auditor General asserts that Parliament should be kept informed of the Year 2000 challenge and the government’s progress in preparing for it. The Committee agrees with this assertion. As the central agency that monitors departmental progress in countering the Year 2000 challenge, the Treasury Board Secretariat is best positioned to provide Parliament with this information. The Committee notes that Secretariat officials responded positively to its requests for more detailed information and wishes to encourage the Secretariat to act expeditiously on its intentions. The Committee therefore recommends:

That Treasury Board Secretariat submit its work plan for government-wide Year 2000 initiatives to the Public Accounts Committee no later than January 31, 1998; and

That Treasury Board Secretariat submit a report to the Public Accounts Committee on the progress that has been achieved across all government departments and agencies by January 31 1998, and at six-month intervals thereafter, up to and including January 31, 2001.

The Committee is anxious that the reports tabled by Treasury Board Secretariat on preparedness for the Year 2000 contain information that is timely and relevant. To that end the Committee recommends:

That progress reports on Year 2000 preparedness include the following information:

- **Progress in each phase of the conversion project (inventory, assessment and planning; conversion; and testing and implementation), including timelines and deadlines, for each department and agency;**
- **An evaluation of the repaired and replaced systems that have been tested and the results;**
- **Mission-critical systems, an impact analysis showing the risk associated with each of them, and an indication of which of these systems have contingency plans in place; and**

- **A continuing evaluation of the costs, broken down by department and agency, of fixing the problem, an aggregate of these costs, and a statement of the method by which they were calculated.**

The Committee is aware that in some instances it may be more appropriate to replace a system rather than upgrade it. Upgrading a system that will have to be replaced in the near future would represent an unwarranted expenditure of scarce resources. Accordingly, the Committee recommends:

That Treasury Board Secretariat, in co-operation with various affected departments, conduct a full and detailed assessment of existing systems with the view of replacing outdated technology where appropriate instead of upgrading it to the year 2000.

The Committee is also deeply aware that departments and agencies will face increasing difficulties in obtaining the software and hardware needed to address the Year 2000 challenge. Accordingly, they will have to assess their needs and, where appropriate, make the necessary purchases as quickly as possible. Treasury Board Secretariat has a role to play in making the departments and agencies aware of this necessity. In light of these considerations, the Committee also recommends:

That Treasury Board Secretariat include, in its progress reports on the response to the Year 2000 challenge, status reports on efforts to obtain the hardware and software from vendors that is needed to solve the problem.

Under normal circumstances, the Office of the Auditor General would conduct a follow up audit two years after the completion of an initial audit. In these circumstances, however, this subsequent action would occur far too late to have any positive influence over the outcome. Constructive participation in the exercise will therefore have to occur much sooner. All of the status reports on the Year 2000 challenge prepared by the Treasury Board Secretariat will be forwarded to the Office of the Auditor General. Consequently, the Committee recommends:

That the Auditor General conduct a thorough review of the reports tabled by the Treasury Board Secretariat on the Year 2000 challenge, and report his conclusions to Parliament.

In closing, the Committee believes that the way in which individual departments and agencies are dealing with this challenge ought to be reported to the Standing Committees of the House of Commons that oversee them. In its Performance Report for the period ending 31 March 1997, Treasury Board Secretariat does provide information on its efforts to resolve the Year 2000 problem. Others should follow this example. Accordingly, the Committee recommends:

That Part III of the Estimates (Reports on Plans and Priorities) for 1998-99, and subsequent fiscal years, and Performance Reports beginning in autumn 1998, for all departments and agencies, contain specific reference to efforts (planned and actual) and expenditures (planned and actual) devoted to meeting the Year 2000 challenge.

Conclusion

Based on the testimony of its witnesses, the Committee believes that progress is being made in the effort to ensure that the major systems of government will continue to function on 1 January 2000. Confirmation of this progress, however, and an indication of its actual extent, will have to await Treasury Board Secretariat's report.

In the meantime, it is important not to be complacent. Indeed, witnesses were unanimous in the view that the challenge is a serious one and will require constant effort.

From the Committee's perspective, the response to the Year 2000 challenge illustrates several of the Committee's principal interests. They are accountability, the need for timely, reliable, and comprehensive solutions to problems, and the assurance that Canadians will be well served by their government.

The Committee is convinced that a satisfactory response to its concerns and recommendations with respect to the Year 2000 challenge will contribute significantly to its solution.

Pursuant to Standing Order 109, the Committee requests the Government table a comprehensive response to this Report.

A copy of the relevant Minutes of Proceedings (*Meetings Nos. 5 and 10*) are tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 11 December 1997

Human Resources Development Canada — A Critical Transition Toward Results-based Management

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

THIRD REPORT

The Standing Committee on Public Accounts has considered Chapter 17 of the April and October 1997 Report of the Auditor General of Canada (*Human Resources Development Canada — A Critical Transition Toward Results-Based Management*) and the Committee has agreed to report the following:

Introduction

Since the 1960s, advocates of public service reform have proposed the adoption of results-based management. This form of administration places an emphasis on results and outcomes, instead of process, an approach that narrowly defines success in terms of the ability to do things 'by the book.' Supporters of results-based management have argued that by adopting this approach, accountability for achieving policy goals would be strengthened, and programs better designed and implemented.

Until recently, the federal public service has been slow to implement a results-based approach to management. As a consequence of diminished resources and fiscal pressures, however, the government has recently begun the transition toward managing for results. This transition has received the support of the Auditor General and, in past parliaments, the House of Commons Standing Committee on Public Accounts.

In his April and October 1997 Report, the Auditor General included a chapter describing the transition toward results-based management in a major department, Human Resource Development Canada, whose activities affect the lives of millions of Canadians. This department is responsible for delivering some of the most important services of the federal government, in areas such as employment insurance, income security, and student loans. The Department's expenditures in these areas are considerable. In 1996-97, for example, it made disbursements totalling \$56 billion, including payments from the Employment Insurance (EI) Account and the Canada Pension Plan (CPP).

Because the Committee assigns a great deal of importance to efforts to achieve results-based management in the federal public service, the magnitude of expenditures involved, and the Canadians affected by the Department's actions, the Committee decided to examine the report on its move toward results-based management. Accordingly, the Committee held a hearing with the Auditor General of Canada, and with Mr. Ian Green, Associate Deputy Minister, and Mr. Marcel Nouvet, Assistant Deputy Minister of Finance and Administration, both of Human Resources Development Canada, on 4 November 1997.

Observations and Recommendations

From its study of the Auditor General's Report, and from its meeting with witnesses, the Committee is generally satisfied that HRDC is making progress in implementing results-based management. At the end of the meeting, Mr. David Rattray, Assistant Auditor General, told the Committee that HRDC "is in fact one of the departments that is making a fairly substantial effort at moving towards results-based management." He added that the Office of the Auditor General has "an overall fairly positive score card on HRDC" in this regard. The Committee takes a similar view.

Despite the Department's accomplishments, however, the Committee believes that progress is uneven in a number of vital respects. In the interests of encouraging the Department to make further progress, the Committee offers the following observations and recommendations.

Performance Indicators

The Department has identified the indicators that it will use to measure its performance in delivering services. These indicators are divided into primary and secondary indicators and differ in terms of their availability to Parliament in departmental performance reports. The results of measures taken under primary indicators are reported to Parliament; those taken under secondary indicators are not. As secondary indicators, cost and efficiency are not part of the information on program performance that is presented to Parliament.

The Committee believes that the absence of this information weakens Parliament's ability to assess how well programs are being delivered. The Committee notes that the Department is already gathering data with respect to cost and efficiency; reporting this data to Parliament should not impose significant cost or extra effort for HRDC. The Committee therefore recommends:

That Human Resources Development Canada should designate cost and measures of efficiency as primary performance indicators and report this information to Parliament in Part III of its Estimates and in its Performance Reports.

Now that the Department has selected its performance indicators, it needs to use them consistently in order to allow performance to be compared from year to year and to establish trend lines. According to the Auditor General's Report, the Department is currently revisiting its key indicators for 1998-99. Mr. Ian Green, Associate Deputy Minister of Human Resources Development, told the Committee that he is aware of the need to sustain present indicators in order for them to be measurable and effective. The Committee welcomes the Department's commitment to its present set of indicators and wishes to see this commitment maintained. It accordingly recommends:

That Human Resources Development Canada should retain its current set of primary and secondary performance indicators for as much time is needed to identify trends and to allow both Parliament and the Department to determine whether performance is improving or deteriorating.

Information for Parliament

A key advantage of results-based management is its ability to generate relevant information for Parliament. This facilitates the Department's accountability to Canadians and to Parliament for the management of its resources and for the results it has produced.

From the Auditor General's Report and testimony given by witnesses, the Committee learned that much — but not all — of the relevant information regarding the Employment Insurance Account is presented to Parliament. However, this information is not available in any single document. This makes it difficult to assess the results achieved in the operation of the Account, which is wholly funded by employers and employees.

The Committee notes that the Department already produces a single annual report on the Canada Pension Plan that is tabled in Parliament. In his audit, the Auditor General comments positively on this report. The Committee also notes that most of the information regarding the EI Account is already publicly available; placing this information in one document should not impose a burden on the Department. Therefore, the Committee recommends:

That, beginning in fiscal year 1998-99, Human Resources Development Canada prepare an annual report on the Employment Insurance Account for tabling in Parliament. This report should compare results against stated objectives and include audited financial statements, a summary of the services provided, the clientele served, and the benefits paid.

Several important pieces of information regarding the Account are currently not available to Parliament. The actuarial analyses used to set the premium rates for the Account are not made public. This is in contrast to the CPP where such analyses are released annually. Also unavailable is a determination of a reasonable reserve for the Account and the time required to accumulate it. The Committee believes that such information is necessary to strengthen transparency surrounding the setting of premium rates. It therefore recommends:

That the Chief Actuarial Officer of the Office of the Superintendent of Financial Institutions prepare, on an annual basis, an actuarial analysis for the Minister of Finance to be used in recommending the setting of premium rates for the Employment Insurance Account, and that the Minister of Finance table this report in the House of Commons; and

That Human Resources Development Canada includes, in an annual report on the Employment Insurance Account, the actuarial analyses used to set premium rates for the Account and the level of a reasonable reserve for the Account along with the time needed to build it.

As the Auditor General points out in his Report, there is a special importance attached to the Employment Insurance Account. In light of the Account's importance, the Committee believes that the obligation to issue an annual report ought to be a formal one with a legislative basis, as is the case with regard to the Canada Pension Plan. The Committee therefore recommends:

That the *Employment Insurance Act* be amended to require Human Resources Development Canada to prepare an annual report on the Employment Insurance Account for presentation to the House of Commons.

Conclusion

Human Resources Development Canada has made significant strides toward the implementation of results-based management. This achievement is particularly commendable in light of the challenges involved in bringing about cultural change in large organizations. Success in this department, one of the largest and most important in government, should serve as an example to other departments and agencies.

The Committee wishes to encourage the Department to make further progress, an effort that the Committee believes will be assisted through adoption of its recommendations.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 6, 12 and 13)* are tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 11 December 1997

Transport Canada: The Commercialization of the Air Navigation System

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FOURTH REPORT

The Standing Committee on Public Accounts has considered Chapter 19 of the April and October 1997 Report of the Auditor General of Canada (Transport Canada - - The Commercialization of the Air Navigation System) and the Committee has agreed to report the following:

Introduction

On 31 October 1996, Canada's civil air navigation system was transferred from Crown ownership to a private not-for-profit corporation, NAV CANADA. NAV CANADA was given a legislated monopoly in perpetuity to operate the system. In return, the Crown received a payment of \$1.5 billion.

This transfer was significant in terms of the nature of the assets and amounts of money involved; this was one of the federal government's largest divestitures. The use of a private contract as a vehicle for the transfer, the creation of a not-for-profit corporation to purchase and operate the system, and the relatively short time in which the transfer was completed, also made this commercialization unusual.

As a consequence of the nature of this transaction, and because future divestitures are likely, the Committee met with the Auditor General of Canada, Mr. L. Denis Desautels, Ms. Margaret Bloodworth, Deputy Minister, Transport Canada (the Department) and Mr. Colin Potts, Deputy Comptroller General, Treasury Board Secretariat, on 18 November 1997, to discuss this issue.

Observations and Recommendations

In his Report and in his opening statement to the Committee, the Auditor General concentrated on the actions taken by the Department in commercializing the air navigation system. According to his assessment, the Department had not conducted a thorough valuation of the system. Furthermore, he argued that when the Department recommended acceptance of a purchase price, it reconciled that price against an adjusted net book valuation. The Auditor General deemed this inappropriate. These observations call into question the Department's achievement of one of two financial objectives that government set for the divestiture — obtaining fair market value for the air navigation system.

The Department did not dispute the core arguments advanced by the Auditor General. Ms. Bloodworth, the Deputy Minister, told the Committee *that "the appropriate way to value [the air navigation system] was a going*

concern and not net book value.” She added that *“in general, in principle we do agree [with the Auditor General] on that issue.”* She also agreed that the documentation used to support both the net and going concern valuations of the system was incomplete. This, she explained, *“was the reason why the Department did not ask its financial advisors to provide a formal valuation opinion.”* Later on she stated that *“in the end fair market value is what a buyer is prepared to pay.”*

However, in her testimony, the Deputy Minister explained that the price obtained for the system was reasonable and a good deal for the government and taxpayers. She stated that the policy objectives established by the government for the commercialization had been attained and expressed general satisfaction with the way in which the transfer had been accomplished.

The Committee acknowledges that even with some slippage the Department fundamentally succeeded in respecting the timeframes for the transfer. It also observes that — in the absence of evidence to the contrary — most of the basic goals set for the divestiture appear to have been met to some degree. The Committee also wishes to affirm that on the basis of the evidence it reviewed, it is satisfied that those involved in the transfer acted with integrity. As the Auditor General stated at the end of the meeting,

“we believe that people probably acted in good faith and we have no reason to think otherwise.”

Nevertheless, the Committee believes that there are several important lessons that can be learned from this divestiture. These lessons need to be applied to future exercises of this sort.

The Department has conducted a study to identify lessons learned from the commercialization and to identify key strategic issues for future divestitures. It has produced an interim report based on this study. In its Performance Report for the period ending 31 March 1996, Transport Canada also indicated that following the transfer, the Department would “develop a framework to determine whether the objectives of the transfer have been achieved.” The Auditor General noted that the Department had yet to make a comprehensive report to Parliament on the results of the divestiture.

In the Committee’s view, a comprehensive report is required so that the Department can provide Parliament with a thorough assessment of the results of the divestiture. Accordingly, the Committee recommends that:

The Department prepare a comprehensive report on the commercialization of the air navigation system for tabling in the House of Commons by 1 April 1998. This report should include a final report on the lessons learned from the transfer, the results of the Department’s evaluation exercise, and a full accounting of the costs involved in the transfer.

In his testimony and in his Report, the Auditor General asserted that the Department did not show due regard to economy in conducting the commercialization. He emphasized 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. (19.26)

The Department agreed that a going concern valuation was most appropriate in terms of determining a purchase price for the system. Its own financial advisors provided a going concern valuation of \$2.4 billion. The

Department obtained a purchase price for the system of \$1.5 billion. The Department reconciled this price through reference to an adjusted net book value for the system of \$1.9 billion.

In order to demonstrate that it exercised due regard to economy in obtaining the purchase price that it did, the Department should be able to reconcile the price against what it agrees is an appropriate valuation. The Committee therefore recommends that:

Transport Canada reconcile the purchase price for the air navigation system by reference to the going concern value provided by its financial advisors and that it include this reconciliation in its report to the House of Commons.

From evidence produced in the Auditor General's Report and during the meeting, the Committee discovered that documentation used in the valuation process was incomplete. It also learned that the Department's financial advisors were not required to provide a formal valuation opinion. Although these factors resulted from conditions surrounding the transfer, the Committee believes that they must be avoided in future divestitures. The Committee therefore recommends that:

The government clearly establish that formal valuations from financial advisors and full financial documentation are absolute requirements that must be satisfied for all divestitures.

Committee also learned that Transport Canada entered into negotiations to transfer the system before it had developed a complete understanding of the assets to be divested. This produced a situation in which a determination of certain key elements of the system occurred during the negotiation phase. It also resulted in valuations that changed during the negotiation process and makes it difficult to determine whether the purchase price of \$1.5 billion is appropriate. The Committee believes that assets to be divested should be clearly defined before negotiation begins. It therefore recommends that:

In all divestitures, the government clearly define and document the nature and value of the assets in question prior to negotiating their transfer.

The Auditor General also raised a number of concerns regarding the manner in which the Department contracted for financial advice used in conjunction with the commercialization. In the Department's view, the contracts were handled in a reasonable manner, given the circumstances. Mr. Colin Potts, Deputy Comptroller General, supported the Department's overall handling of the transfer.

The Committee is concerned, however, that while the Department may not have violated any procedures set forth for contracting, certain of its actions could and should be improved. In order to ensure that, in future, all contracts are issued in a fair and appropriate manner, the Committee recommends that:

Treasury Board Secretariat conduct a thorough review of the government's contracting regulations, with specific reference to the concerns raised in the Auditor General's Report, and that it report its conclusions to this Committee no later than 31 May 1998.

The Committee notes that in handling this divestiture, Transport Canada was engaging in an activity outside its normal sphere of operations. Such divestitures are complex and require a set of specific skills not

traditionally found in most government departments. As a consequence, the Committee believes that there would be an advantage in having a third party assume responsibility for overseeing future divestitures. Therefore, the Committee recommends that:

When government is contemplating a divestiture, it form a special privatization committee with the specific mandate and skills to supervise the divestiture.

In his Report and testimony to the Committee, the Auditor General observed that Transport Canada had yet to provide Parliament with a comprehensive report on the results of the divestiture. The Committee believes that the results of all divestitures, particularly when they involve major assets and operations of government, should routinely be reported to Parliament. Therefore, the Committee recommends that:

The government, upon completion of any divestiture, table a comprehensive report on the results in the House of Commons. Such reports should include a statement of the objectives set for the divestiture, the full costs of the exercise, and the results.

In closing, the Committee notes that the government decided to transfer the air navigation system to a not-for-profit organization that it created for this purpose. This organization — NAV CANADA — was given a legislated monopoly in perpetuity with the legal right to recover all of its costs and accumulate reserves. The Auditor General indicated in his testimony that the legislation enables NAV CANADA “to charge users for the service’s availability rather than its use.” The Committee observes that while NAV CANADA is made up of partners and is responsible for providing a service that is safe, it has no shareholders to whom it must answer. In light of these general observations, the Committee recommends that:

In conducting future divestitures, the Government devote careful thought to the nature of the entity that will assume the assets and operations, and the context within which it will operate.

As the structures of government undergo change, it is likely that divestitures will continue. It is vital that the lessons learned from previous divestitures be learned and applied. It is also important that these exercises be transparent and conducted with due regard to economy.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A dissenting opinion from the Bloc Québécois is appended to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 8 and 14)* are tabled.

Respectfully submitted,

JOHN WILLAMS

Chair

Bloc Québécois Dissenting Opinion

Fourth Report of the Standing Committee on Public Accounts

Commercialization of the Air Navigation System:

Liberal Bad Management in All Its Glory

The Liberals have thrown away almost one billion dollars of public money by selling off cheap a monopoly in perpetuity on the air navigation system. Once again they have failed to display either strict standards or professionalism, as the Auditor General pointed out in his report of October 1997.

In addition to having literally wasted \$900 million, no one in the government is willing to take responsibility for the mess, or for the decisions the new agency may make in the future. By making NAV Canada independent of the government, no member of the government -- and most definitely not the Minister of Transport -- seems willing to answer for the loss of the \$900 million, and still less for NAV Canada's decision to let 1,100 of its employees go.

The Bloc Québécois accuses the Liberals of having cheated the taxpayers of Quebec and Canada out of this \$900 million, and the Minister of Transport of having washed his hands of the 1,100 employees who are losing their jobs. We hope that the government will implement the recommendations in the report of the Committee.

REPORTS TO THE HOUSE

Thursday, 12 February 1998

Health Canada — First Nations Health

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FIFTH REPORT

The Standing Committee on Public Accounts has considered Chapter 13 of the April and October 1997 Report of the Auditor General of Canada (*Health Canada — First Nations Health*) and the Committee has agreed to report the following:

Introduction

As a matter of policy, the federal government provides health services to Canada's approximately 640,000 status Indians and Inuit (First Nations). Health Canada is responsible for this service through its Health Services Branch. The goal set by the Department is to "assist" First Nations to "attain a level of health comparable for that of other Canadians living in similar locations." In fiscal year 1995-96, expenditures in this area totalled approximately \$1 billion.

In accordance with overall government priorities, Health Canada is moving away from direct delivery of health services to First Nations. Instead, status Indians and Inuit will increasingly manage and control their own health services at the community level.

Due to the large numbers of Canadians directly affected, the costs involved, and the crucial transition to community control that is currently taking place, the Committee decided to examine Health Canada's management of this service. To this end, the Committee met with Mr. Denis Desautels, the Auditor General of Canada, and Mrs. Maria Barrados, the Assistant Auditor General, on 26 November 1997. Mr. Paul Cochrane, Assistant Deputy Minister, Medical Services Branch, Dr. Jay Wortman, Director General of Non-Insured Health Benefits, and Ms. Myra Conway, Director of Programs and Operations Coordination, appeared on behalf of Health Canada.

Observations and Recommendations

Health Canada's Health Services Branch oversees the provision of health services to First Nations under two basic programs. The first, Community Health Programs, is made up of programs and activities related to public health and health education, and strategies to deal with specific problems such as drug and alcohol abuse. Non-Insured Health Benefits (NIHB), the second program, provides prescription and over-the-counter drugs, dental services, and transportation for medically required services. In fiscal year 1995-96, expenditures on these two programs amounted to approximately \$450 and \$516 million respectively.

In his Report of October 1997, the Auditor General was critical of the Department's management of these programs. He indicated that the Department was not paying sufficient attention to the delivery of Community Health

Programs nor to the results achieved in terms of improved health. With respect to the Non-Insured Health Benefits, he found that the Department's lack of rigorous management and control may have contributed to poor community health rather than its improvement. He also argued that in the absence of stringent audits, money was being spent in ways contrary to the program's intent. The Auditor General reiterated these observations in his statements to the Committee.

The Department did not disagree with the Auditor General's observations. Instead, departmental witnesses emphasized that Health Canada was already aware of many of the problems brought to light by the audit, and is now taking steps to correct them. The witnesses indicated that cost management measures are having positive results — a factor noted by the audit. They also argued that delivery of health services to First Nations faces numerous challenges and that problems associated with the programs were not dissimilar to those found in other health service regimes.

The Department has agreed to virtually all of the audit's recommendations and has pledged to implement each one of them. Some efforts are already underway to implement changes while others are being planned. The Committee welcomes Health Canada's commitment to resolve the problems identified by the audit. While in some cases, the Department has been aware of these difficulties for almost ten years, the availability of new technologies and methodologies should result in a speedier response.

The Committee is anxious that the Department fulfil its commitments and that the changes will result in better management of health services and improved health for First Nations communities. Accordingly, the Committee makes the following recommendations.

Community Health Programs

Community Health Programs are delivered by First Nations' communities under a variety of arrangements with the Department. These arrangements differ in terms of the degree of control exercised by the communities concerned. According to departmental data, as of 31 March 1997, 60 percent of First Nations' communities were delivering programs under separate contribution agreements. In theory, this kind of arrangement gives communities the least amount of control and requires the greatest departmental involvement.

The Department's goal is to encourage communities to exercise greater control offered under arrangements known as "transfer agreements." According to the Auditor General, the Department has estimated that by 1999-2000 approximately 60 percent of First Nations will be delivering their health services under this type of arrangement. (13.24) The Auditor General approves of the accountability framework, developed by the Department, that will govern the transfer process.

The Committee supports the goal of greater community control. Nevertheless, the audit's findings give reason for concern that the transfer process may not be adequately managed. The Department was not carefully monitoring separate contribution agreements to ensure that program conditions were being met. The accountability framework for the transfer process— although good in itself — was not being applied with sufficient rigour.

The Department must ensure that the transfer process functions smoothly, that First Nations develop the capacity to control their health services, that the health of communities and individuals is enhanced, and that the Minister of Health's accountability for the expenditure of public funds and health outcomes is properly supported. To do so, the Department must apply the transfer framework as intended. The Committee therefore recommends:

That Health Canada monitor the transfer of the delivery of Community Health Programs to First Nations communities and work with the communities to ensure that the conditions set forth in the accountability framework are met. In particular, the Department must ensure that the audit (both financial and comprehensive) and evaluation requirements of all transfer agreements are satisfied.

The director of the Medical Services Branch, Mr. Paul Cochrane, told the Committee that it is the policy of the Department that First Nations take control of the health programs “at a pace and at a time of their own choosing.” As a consequence, some communities may decide not to enter into transfer agreements. In these instances, Health Canada must improve its monitoring, in accordance with its own policies, to ensure that it can fulfil its obligations. The Committee therefore recommends:

That Health Canada monitor those aspects of the Community Health Program that are not affected by transfer agreements. This monitoring function must be done in accordance with departmental policies, be supported by thorough evaluation of risk, and targeted accordingly.

The Committee believes that it is essential that Parliament be kept informed of the progress of the transfer process and the results it produces. Parliament must also receive assurance from the Department that all Community Health Programs are being adequately monitored and that all reports and audits are completed and submitted as required. Accordingly, the Committee recommends

That Health Canada provide information on the status of Community Health Programs in its annual Performance Reports. Information on the status of the transfer process, the Department’s monitoring activities, audits and reports completed, and health outcomes achieved under the programs should be included.

Non-Insured Health Benefits

The audit’s most serious findings involve the Department’s delivery of the Non-Insured Health Benefits program. According to the Auditor General, poor management and control have contributed to the inappropriate use of benefits supplied under the program.

The Department has acknowledged that problems exist and has taken steps to resolve them. Most importantly, it has implemented a point-of-sale system designed to identify cases of possible prescription drug abuse. This system was intended to be fully operational by the end of 1997; the Committee asks that the Government confirm the same in its comprehensive response to this Report.

These measures have the potential to reduce many of the problems associated with provision of prescription drugs under NIHB. There are, however, areas in which the point-of-sale system should be improved. As a result of legislation in various jurisdictions, information is restricted to the last three prescriptions. Pharmacists can override warning messages sent by the system. As yet, there is no compensation scheme in place that will give pharmacists an incentive to decline prescriptions on the basis of these warnings.

The Committee notes that in British Columbia, privacy legislation has been amended in order to allow pharmacists to see a fourteen-month prior history of prescriptions. The Committee therefore recommends:

That Health Canada explore the possibility, with various jurisdictions, of having access to information and privacy legislation amended in order to allow its point-of-sale system to provide more information on recent prescriptions.

The Committee also recommends:

That Health Canada monitor the use of overrides by pharmacists and step up its efforts to devise an incentive scheme for those pharmacists who do not fill prescriptions when warning messages are issued.

The Department has indicated that the Non-Insured Health Benefits program will become available for transfer to First Nations communities as of 1 April 1998. Greater community control over this program offers the potential for better delivery. The Committee is concerned, however, that First Nations communities not inherit systemic problems associated with the program. The Committee therefore recommends:

That Health Canada fix systemic problems with the NIHB program before the program becomes available for transfer to First Nations communities.

The Committee is also concerned that when the transfer of the NIHB program begins, it be conducted in a way that will build capacity in the First Nations communities and support accountability relationships. The Committee notes the Auditor General's endorsement of the framework being used to govern the transfer of the Community Health Program. It therefore recommends:

That Health Canada adopt and apply the framework for transferring Community Health Programs when it conducts the transfer of the Non-Insured Health Benefits program to the First Nations.

Claims Processing for Pharmacy and Dental Providers

The audit revealed problems in the processing of claims submitted by pharmacy and dental providers under the NIHB program. These problems were largely the result of an inadequate audit regime.

In October 1997, the Department announced that a new five-year contract for claims processing had been awarded. This contract will take effect as of 1 July 1998.

Dr. Jay Wortman told the Committee that the Department is aware that the language in the existing contract "was weak in the area of audit," and that it was planning to have stronger language incorporated into the new contract. The Committee welcomes this determination on the part of the Department and recommends:

That Health Canada submit a copy of the new contract for processing pharmacy and dental claims under the NIHB program to the Committee by 1 June 1998.

Optimal Therapy

It is the Committee's view that Health Canada should establish optimal therapy as a central goal of the NIHB program. This would mean ensuring that those covered by the program get the appropriate drugs they need to improve their health status or particular condition. If this were the program's goal, the Committee is convinced that there would be greater opportunities for savings because clients, physicians and pharmacists would be better informed and better care provided. While the Department does include aspects of an optimal therapy approach to some elements of the program, it should apply it to the program as a whole. The Committee therefore recommends:

That Health Canada work with First Nations Communities to establish optimal therapy as the central goal of the NIHB program and include references to this effort in its annual Performance Reports.

Conclusion

As noted, the Department has made a commitment to implement the entire list of the Auditor General's recommendations. Mr. Cochrane told the Committee that "each one of these recommendations ... will be followed up with a detailed action plan." He indicated his willingness to provide the Committee with a copy of this plan. Ms. Myra Conway told the Committee that a draft of the plan would be completed by the end of November 1997. The Committee recommends:

That Health Canada provide the Committee with a copy of its action plan for carrying out the recommendations made by the Auditor General by 30 April 1998. This plan should include target implementation dates, and a discussion of how the Department proposes to monitor and report the changes and the results that are achieved.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 11 and 16)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 26 March 1998

Fisheries and Oceans Canada — Pacific Salmon: Sustainability of the Resource Base

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SIXTH REPORT

The Standing Committee on Public Accounts has considered Chapter 28 of the December 1997 Report of the Auditor General of Canada (*Fisheries and Oceans Canada Pacific Salmon: Sustainability of the Resource Base*) and the Committee has agreed to report the following:

Introduction

The pacific salmon is a valuable resource for the citizens and communities of British Columbia as well as for Canada as a whole. The commercial salmon fishery was worth \$265 million annually during 1986 – 1995. A recent survey indicated that the recreational fishery generated more than \$228 million in direct expenditures by anglers in 1990 alone. Many Canadians, especially the citizens and communities in British Columbia, have expressed a strong interest in, and commitment to, preserving this important resource for the use and enjoyment of generations to come.

In light of the value of this resource and its importance to the people of British Columbia and Canada, the Committee decided to study Chapter 28 of the Auditor General's December 1997 Report. The audit in this chapter focused on the sustainability of the salmon resource base, with an emphasis on the conservation and protection of salmon habitat. A second phase of the audit will look at salmon fisheries management including fishing plans and the allocation of resources to major users. The Auditor General intends to report the results of this second phase in 1999.

To understand the challenges involved in the conservation and preservation of pacific salmon habitat, the Committee met on 12 February 1998 with Mr. Denis Desautels, the Auditor General of Canada, and Mr. John McCullough, Principal of Audit Operations, and Mr. Geoffrey Robins, Director of Audit Operations, from the Office of the Auditor General of Canada. Mr. Wayne Wouters, Deputy Minister, Ms. Cheryl Fraser, Assistant Deputy Minister – Policy, Mr. Scott Parson, Assistant Deputy Minister — Science, and Ms. Donna Petrachencko, Regional Director, Pacific Region, represented the Department of Fisheries and Oceans.

The Committee learned that although pacific salmon are doing well at the aggregate level, individual species such as the chinook and coho may be declining and that many small stocks are under stress or are threatened.

There are several causes for stress on the salmon resource, including changes in the ocean and climate. However, evidence shows that the alteration of salmon habitat leading to its loss is a significant factor in placing stress on the resource.

Since jurisdiction over the fisheries in Canada is divided between the federal and provincial governments, the Department must work with the Province of British Columbia in order to deliver its habitat program. It must also work closely with communities, aboriginal groups, interested groups and individuals, and other stakeholders.

The Department of Fisheries and Oceans is mandated, under the *Fisheries Act*, to protect fish habitat from disruptive and destructive activities. 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). The Policy's objective is "net gain" which is met through concentration on three goals: conservation, restoration, and development of fish habitat. In 1996-97, the Department's Pacific Region spent \$10.3 million, or 11.6 percent of its total fisheries management budget, on habitat management activities.

The Department must work in a challenging and complex environment to deliver its habitat program. Recent agreements between the governments of Canada and British Columbia promise better co-ordination and delivery of efforts to conserve salmon habitat. Apart from these agreements, however, the Committee believes that there are several areas in which the Department must improve its performance if it is to achieve the objective of "net gain" established by its Habitat Policy.

Observations and Recommendations

In his Report and his testimony, the Auditor General indicated the importance of smaller salmon stocks of all species in protecting genetic diversity and ensuring the sustainability of the resource as a whole. Yet the Department has tended to concentrate its efforts on the major stocks with the result that it lacks assessment data on many of the smaller stocks. The Committee is concerned that this focus neglects the importance of smaller stocks. It notes that Deputy Minister Wouters agreed that there is a need to provide greater emphasis on the whole area of minor stocks and recommends:

That the Department of Fisheries and Oceans adopt a balanced approach to the protection of, and production from, all salmon stocks and that it allocate its resources accordingly. This approach must be clearly reflected in the Department's policies, accountability documents and other publications.

Furthermore, the Committee recommends:

That the Department of Fisheries and Oceans establish a strategy to collect and assess the data necessary to monitor and report on the status of smaller stocks, and that it establish and make public a deadline for doing so.

Apart from the limited data and assessment with regard to small stocks as alluded to in paragraph 9 the audit found that information on salmon stocks is not well co-ordinated and is not always available easily. The Department will need this information if it is to concentrate its efforts and resources where they will be most effective. The Department's partners in habitat protection will also need this information for their own planning purposes. The Committee therefore recommends:

That the Department of Fisheries and Oceans develop and implement a strategy, in co-operation with the Province of British Columbia and other partners in habitat management, to collect and manage information on Pacific salmon stocks. This strategy must include clear goals, definitions of responsibility, and target implementation dates.

The Committee is of the view that groups and individuals interested in contributing to habitat preservation represent an invaluable resource for the Department. This is particularly so given the limited resources available. These groups and individuals not only help preserve habitat, they are also a source of information on the status of salmon stocks. Their contribution must be encouraged and the Department is making efforts in this respect. The Committee wishes to see these efforts continue and therefore strongly recommends:

That the Department of Fisheries and Oceans develop and implement a plan whose specific purpose is to engage and encourage the assistance of groups and individuals interested in preserving salmon stocks and habitat. This plan — including target implementation dates — must be developed in close consultation with the groups and individuals themselves.

The Committee notes that the Department delivers some aspects of its Habitat Policy through arrangements with its partners such as the Government of British Columbia and First Nations. The Committee is concerned, however, by a general absence of accountability frameworks in many of these agreements. The audit finding that these arrangements are not subject to monitoring and audit by the Department is also of concern. The Committee believes that this issue should be resolved when future arrangements are set in place. It therefore recommends:

That as it negotiates agreements with its partners in habitat management, the Department of Fisheries and Oceans negotiate the inclusion of accountability frameworks to ensure that the requirements of the *Fisheries Act* are met. These frameworks must include clear statements of expectations, responsibilities, and provisions for monitoring, auditing, and the reporting of outcomes.

Furthermore, the Committee recommends:

That the Department of Fisheries and Oceans monitor and audit the arrangements under which it delegates habitat management responsibilities.

The audit found that the Department relies heavily on reactive measures to protect salmon habitat. These measures are focused on the review of proposed development projects with a potential impact on salmon habitat. The Department can recommend changes to projects to offset damage to habitat. This, however, necessitates monitoring to ensure compliance and the assessment of the impact of proposed changes on habitat. The audit found that the Department did not place sufficient emphasis on these latter measures, particularly with regard to smaller projects. The Committee believes the Department must place more emphasis on monitoring and follow up and therefore recommends:

That the Department of Fisheries and Oceans establish the level of monitoring and follow-up of habitat projects that is necessary to ensure compliance and assess the impact on 'no net loss.' The need to monitor small projects must be factored into this consideration.

To protect habitat, the Department should also adopt a more proactive approach by becoming involved in the planning stages of projects at the community level. This provides an opportunity to ensure that projects will

either avoid harming habitat or that mitigating or compensatory aspects can be built into them. The Committee learned however, that the Department has encouraged rather than instructed its staff to become involved in planning initiatives. The Committee believes that such involvement will solve problems before they develop. It also takes note of Ms. Petrachenko's testimony that "if our [the Department's] proactive work on the planning front doesn't work, we end up having to use enforcement...." Involvement at the planning stages might therefore reduce the necessity for after-the-fact monitoring and enforcement. Accordingly, the Committee recommends:

That the Department of Fisheries and Oceans revise its Habitat and Conservation Guidelines of 1994 in order to instruct its staff to become involved in major integrated resource and land use planning initiatives.

The Auditor General reports that the Department has not prepared an overview report on the status of fish habitat conservation in Canada since the introduction of the Habitat Policy in 1986. Mr. Wouters told the Committee that the Department is currently undertaking a strategic review of its habitat management program in British Columbia. He also made a commitment to appear before the Committee once the review is completed to summarize the results and discuss how the Department will proceed. He anticipated that the review will be completed in October 1998. The Committee also notes the Department of Fisheries and Oceans' positive general response to the recommendations made by the Auditor General. The Department indicated that it has acted on some recommendations and is planning to address others. The Committee welcomes Mr. Wouters' and the Department's commitments and recommends:

That the Department of Fisheries and Oceans conduct a full strategic review of its Habitat Policy to determine its performance in achieving the Policy's goals and overall objective of 'net gain', and that it report the results by December 1998. This report must also contain the Department's agreed upon responses to the concerns and recommendations of the Auditor General as expressed in Chapter 28 of his December 1997 Report.

The Committee believes that such evaluations must be conducted at regular intervals and the results provided to Parliament. It therefore recommends:

That the Department of Fisheries and Oceans establish a timetable for the regular review and evaluation of its habitat management policies and practices; and

That the Department of Fisheries and Oceans report the results of habitat management and policy reviews to Parliament in its annual Performance Reports.

Furthermore, because the Committee believes that habitat management is a vital component of the Department's mandate, it recommends:

That the Department of Fisheries and Oceans include, in updates of its sustainable development strategy, references to its habitat management policies and practices.

Finally, because the Committee believes that information on the status of Pacific salmon resource is of vital importance, it recommends:

That the Department of Fisheries and Oceans include information on the status of the Pacific salmon resource at both the species and stock levels in its Annual Report to Parliament.

In closing, the Committee is aware that the protection of habitat is one component of the effort to ensure the sustainability of the Pacific salmon. It notes that the Auditor General will conduct a second phase of his audit of the Pacific salmon fishery that will focus on other aspects of sustainability. The Committee considers it important to view sustainability in its entirety and may revisit the results of the first phase in conjunction with any review of the second.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 17 and 23)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 2 April 1998

Public Accounts of Canada 1996-97

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SEVENTH REPORT

The Standing Committee on Public Accounts has considered the *Public Accounts of Canada 1996-97* and the Committee has agreed to report the following:

Introduction

The *Public Accounts of Canada* summarise the financial transactions made by the Government of Canada during a given fiscal year, ending on 31 March. Included in the Public Accounts are statements of the Government's assets and liabilities, revenues and expenditures, the accumulated deficit, changes in financial position, and a statement of transactions. The latter reveals the extent to which cash going out from the government exceeded cash coming in, with the resulting net borrowing.

These financial statements are presented to the Auditor General of Canada who audits them and provides an independent opinion to the House of Commons. The statements along with the Auditor General's opinion are tabled in the House of Commons in the form of the *Public Accounts of Canada* and are referred to the Standing Committee on Public Accounts for examination.

On 28 October 1997, the *Public Accounts of Canada 1996-97* were tabled in the House of Commons and referred to the Committee. On 9 December 1997, the Committee met to examine the *Public Accounts of Canada*. Mr. Raymond Dubois, Deputy Auditor General, Mr. Ron Thompson, Assistant Auditor General, and Mr. John Hodgins, Principal of Audit Operations, appeared as witnesses from the Office of the Auditor General of Canada. Mr. J. Colin Potts, Deputy Comptroller General, and Mr. Rick Neville, Assistant Secretary and Assistant Comptroller General, appeared as witnesses on behalf of Treasury Board Secretariat.

This report presents the Committee's observations and recommendations arising from that meeting.

Observations and Recommendations

According to section 6 of the *Auditor General Act*, the Auditor General shall examine the financial statements as required by the *Financial Administration Act* and contained in the *Public Accounts* 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.)

Although the Auditor General indicated that in his opinion, the financial statements for 1996-97 “present fairly, in all material respects, the financial position of the Government of Canada as of March 31 1997,” he added that:

The 1996-97 deficit is overstated by \$800 million, and both accounts payable and accrued liabilities as well as the accumulated deficit are overstated by the same amount. This results from the recording of a transaction related to the Canada Foundation for Innovation as if it were a liability, which is contrary to the stated accounting policies of the Government of Canada as set out in note 1 to the financial statements. The \$800 million has been recorded as owing to an organization that was not in existence at March 31, 1997 (the Foundation was not legally created until April 1997). Further, the funding agreement between the Government and the Foundation was not signed until the July 1997.

During the meeting, witnesses from the Auditor General’s Office confirmed that a qualified opinion had been issued for the public accounts for fiscal year 1996-97. Mr. Raymond Dubois, Deputy Auditor General, informed the Committee that the qualified opinion is

... a very serious matter. What this type of opinion says is that members of this Committee and other users of the financial statements should be aware that they contain a material or significant misstatement.

In his testimony, Mr. Ron Thompson reiterated that in the view of the Office of the Auditor General the \$800 million transaction was recorded before the Canada Foundation for Innovation (the Foundation) was established and the transfer actually made. He argued that recording the transaction in this manner contravened the government’s own accounting rules and the accounting and reporting practice recommended by the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants. Instead, the transaction should have been recorded in the 1997-98 fiscal year, the period during which the Foundation was created and the actual payment made.

Mr. Potts acknowledged that the Auditor General and the government could not reach agreement on the accounting treatment for the transfer of \$800 million to the Foundation. In contrast to the Auditor General’s view, the government believes that the costs should be charged in 1996-97, the fiscal year in which the Cabinet’s decision to establish the Foundation and transfer the funds was taken and made public. According to Mr. Potts, the government considered that this decision constituted “an irrevocable commitment,” and that recording the decision in the 1996-97 fiscal year “reflected the economic reality of financial decision-making” at the time. He indicated furthermore that the government’s commitment was confirmed by Parliament through the passage of legislation before the 1996-97 books of government were closed. With regard to the transfer of funds, Mr. Potts also pointed out that payment — although it took place in July 1997 — occurred before the accounts for the year were closed off. He concluded that in its accounting treatment of this transaction, the government had adopted a conservative approach.

In response to questions from the Committee and in subsequent testimony, the witnesses firmly maintained their positions on this matter.

The Committee was divided on the issue of whether or not the accounting treatment of this transaction was appropriate. Some members shared the view of the Office of the Auditor General; others believed that the government’s explanations were satisfactory and reasonable.

We note the points raised by the Auditor General and understand fully the rationale and basis for his concerns. However, the Committee is of the view that a broader range of factors must be taken into account for a changing economy and a changing financial position in Canada.

For example, these include such items as conservatism, consistency, comparability, and clarity of the statements to the reader.

We also note the remarks of Mr. Ron Thompson, Assistant Auditor General, that the government “has made considerable progress in recent years in making its annual financial statements more understandable and more useful.” He added that Canada “remains at the forefront internationally for this crucial form of accountability reporting...this is something that we should all take great pride in.”

We especially note the clear and well-developed opinion of the Finance Department in conjunction with the Comptroller General’s office with regard to the accounting practices employed in these financial statements (A copy of the relevant documentation is attached to this report. *See Appendix “A”*).

The Committee believes that transparency and accountability to Parliament and Canadians are best served by recording non-recurring liabilities in the year in which they are incurred, provided the enabling legislation or authorization for payments receives parliamentary approval before the financial statements for that year are closed.

Therefore, the Committee accepts and applauds the Government for its actions of making its financial statements more transparent and understandable by Canadians.

A second important issue raised by the Auditor General involves the manner in which the government records and reports the estimated liabilities of its employees’ pensions. The Auditor General observes that there is a \$20 billion gap between the liability shown for these pensions (\$114 billion) and the liability estimated by the government’s actuaries (\$94 billion). He is sufficiently concerned that if adjustments are not made in 1998 to bring accounting into line with PSAAB guidelines, he will seriously consider qualifying his audit Opinion for that year.

Mr. Potts told the Committee that the government is seriously considering the Auditor General’s recommendation and hopes to have the issue resolved by 31 March 1998. In the meantime, the government is adhering to a legislative requirement that obliges it to calculate interest on a balance in a superannuation account. This results in a higher amount.

The Committee believes that the government should act expeditiously to address the Auditor General’s concerns and therefore recommends:

That the government take all necessary measures — including legislative amendment and adjustment of its stated accounting policies — needed to record and report liabilities for the pensions of its employees in accordance with PSAAB guidelines. Such measures should be completed and in place for the 1998-99 fiscal year.

The Auditor General also listed accounting for environmental liabilities and contingencies, capital assets, tax revenue, and the Debt Servicing and Reduction Account as matters of continuing concern. In his testimony, Mr.

Potts indicated the government's intention to address each of these concerns in a timely manner. The Committee trusts that the government will act quickly and in consultation with the Auditor General to resolve these issues.

Conclusion

The Committee takes its responsibility for reviewing the Public Accounts very seriously. As Mr. Neville indicated in his opening statement:

The main purpose of this financial reporting [contained in the Public Accounts of Canada] is to provide information to Parliament, and thus to the public, to allow an understanding of the financial affairs of the government and of the resources with which it has been entrusted.

The Committee also firmly agrees with Mr. Raymond Dubois, who stated in his opening remarks that the government's financial statements "are an important accountability document." Thus the Committee considers that its review of these statements is a central element in holding government to account on behalf of citizens and taxpayers. It is because this document and its review by a committee of Parliament is so vital that this Committee believes so strongly in the necessity for clear accounting rules and rigorous, consistent adherence to them. There must be no room for confusion regarding the manner in which the use of public funds is reported.

In his opening remarks, Mr. Thompson stated that the government "has made considerable progress in recent years in making its annual financial statements more understandable and more useful." He added that Canada "remains at the forefront internationally for this crucial form of accountability reporting. ... this is something that we should all take great pride in." The Committee agrees and believes that its recommendations and continuing efforts by the government and the Office of the Auditor General will further enhance the credibility and utility of the government's financial statements.

The Committee also notes that at the international level there is considerable variance in the way that governments record and report their financial statements. This often makes international comparison difficult. The Committee recommends:

That the Government of Canada seek opportunities to establish international accounting standards for governments.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A dissenting opinion from the members of the opposition parties is appended to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 13, 16 and 23)* is tabled.

Respectfully submitted,

John Williams

Chair

Dissenting Opinion to the Seventh Report of the Standing Committee on Public Accounts

Respectfully submitted by:

Odina Desrochers, M.P.
Jason Kenney, M.P.
Philip Mayfield, M.P.
Elsie Wayne, M.P.

Gurmant Grewal, M.P.
René Laurin, M.P.
Lorne Nystrom, M.P.
John Williams, M.P.

In lieu of paragraphs 3-7 on page 4 and paragraph 1 on page 5, all the parties in Opposition agree and submit the following:

Despite this lack of a common perspective, the Committee is in agreement that the rules governing the calculation of the government's financial statements must be clear and appropriate. They must also be adhered to without deviation; practice and policy must be in alignment. The Committee takes note of Mr. Neville's statement that the government "for the most part" follows accounting policies recommended for governments by the Public Sector Accounting and Auditing Board (PSAAB) of the Canadian Institute of Chartered Accountants. (15.40). Thus, while the federal government alone determines its accounting policies, it does so within the framework of guidelines established by the PSAAB, an independent third party. The Committee also notes that this is the second consecutive occasion on which the Auditor General has issued a qualified opinion as a result of a similar accounting practice by government. If the government and the Auditor General cannot resolve this matter, there is a possibility that the Auditor General might issue a reservation on the next set of government financial statements. The Committee believes that every effort must be made to avoid this possibility. Accordingly, the Committee recommends:

That the Government of Canada and the Auditor General review and attempt to reconcile their differences of interpretation with regard to government accounting policies with careful reference to the accounting and financial reporting recommendations of the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants.

Furthermore, the Committee recommends:

That, if the Government and the Auditor General are unable to resolve this problem, the matter be submitted to the Public Sector Accounting and Auditing Board of the Canadian Institute of Chartered Accountants for further clarification.

In addition, in lieu of paragraph 3 on page 6, all the parties in Opposition agree to the following:

The parties in Opposition laud the efforts of the Government to ensure that its financial statements are transparent, understandable and more useful. However, due to the concerns that the Auditor General has raised regarding the Government's accounting practices, it is clear that these goals are not being met.

The parties in Opposition believe that the Government must focus their efforts to ensure that these goals are met in accordance with the expectations stated by the Auditor General of Canada.

REPORTS TO THE HOUSE

Tuesday, 28 April 1998

The Standing Committee on Public Accounts has the honour to present its

EIGHTH REPORT

In accordance with its Order of Reference of Thursday, February 26, 1998, your Committee has considered Vote 30 under FINANCE of the Main Estimates for the fiscal year ending March 31, 1999 and reports the same.

A copy of the relevant *Minutes of Proceedings (Meeting No. 27)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Tuesday, 12 May 1998

The Processing of Refugee Claims

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

NINTH REPORT

The Standing Committee on Public Accounts has considered Chapter 25 of the December 1997 Report of the Auditor General of Canada (*Citizenship and Immigration Canada and Immigration and Refugee Board — The Processing of Refugee Claims*) and the Committee has agreed to report the following:

Introduction

The process of determining refugee status is difficult and takes place within the context of complex laws and regulations. A balance must be achieved between compassion for refugee claimants and the fundamental needs of Canadian society; a society committed to providing safe haven for genuine refugees.

The costs associated with the refugee claims processing system are considerable. Fragmentary data indicate that the administrative costs to the federal government of processing claims amounts to approximately \$100 million each year. The provinces are responsible for providing a variety of social services to support claimants. In Quebec and Ontario, a partial estimate puts these costs at about \$100 million each on an annual basis. Due to changing arrangements, particularly in Ontario, many of the costs related to the support of claimants are borne by municipalities. In summary, the costs are such that widespread benefits could be achieved through greater efficiencies in the processing of claims.

Because determination of refugee status is important and because the associated costs are substantial, the Committee decided to examine Chapter 25 of the Auditor General's December 1997 Report. Accordingly, on 5 February 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Richard Flageole (Assistant Auditor General) and Mr. Serge Gaudet (Principal, Audit Operations) from the Office of the Auditor General. Ms. Janice Cochrane (Deputy Minister) and Mr. Marc Lafrenière (Associate Deputy Minister) represented the Department of Citizenship and Immigration. Ms. Nurjehan Mawani (Chairperson), Mr. Paul Thibault (Executive Director) and Mr. John Frecker (Deputy Chairperson, Convention Refugee Determination Division) represented the Immigration and Refugee Board.

Owing to the complexity and importance of this issue, a second meeting was held on 17 February 1998. Mr. Denis Desautels, Mr. Richard Flageole, and Mr. Serge Gaudet appeared as witnesses from the Office of the Auditor General. Mr. Greg Fyffe (Assistant Deputy Minister, Policy and Program Development), Mr. Georges Tsai (Assistant Deputy Minister, Corporate Services), and Mr. Brian Grant (Acting Director General, Enforcement Branch) appeared on behalf of the Department of Citizenship and Immigration. Mr. Paul Thibault and Mr. John Frecker represented the Immigration and Refugee Board.

Background

The responsibility for processing refugee claims is divided between the Department of Citizenship and Immigration (the Department) and the Immigration and Refugee Board (the Board).

The Department and the Board are independent from one another. The Department decides whether claimants are eligible for access to the refugee determination system. The Convention Refugee Determination Division within the Board is then responsible for determining if the claimant really is a refugee under the terms of the *United Nations Convention Relating to the Status of Refugees*. If the claim is rejected, then the Department is responsible for removing the claimant from Canada. The Department is also responsible for handling other avenues of appeal open to rejected claimants who still wish to remain in Canada.

This structure and its practices were implemented in 1989 in response to a backlog of some 85,000 unprocessed claims. The new arrangements were expected to produce quick, equitable and efficient resolution of claims and the removal of failed claimants.

Observations and Recommendations

The Committee learned that the current structure and practices are not meeting their objectives. The backlog of unprocessed claims is high (close to 37,500 awaiting a decision by the Department or the Board as of 31 March 1997) and processing is lengthy. In 1996-97, it took an average of 13 months to process a claim. Removals of rejected claimants were also problematic: of the approximately 31,200 claimants denied refugee status between 1993-1997, or were not otherwise accepted in Canada, only 22 percent had confirmed their departure. The Auditor General estimates that a claimant can expect to stay in Canada for more than two and a half years. He also estimates that those who have been ordered removed but have not left on average have been in Canada for two and a half years.

The causes of these problems are not confined to any specific area of the claims processing system; they are found at every stage of the process. The Auditor General reports that he found “problems of efficiency and operational effectiveness and a lack of rigour at various stages,” and observed “weaknesses that pervade the entire process — a lack of co-ordination, integration, strategic direction, and overall follow-up.” (25.35) As he points out, piecemeal change will not solve the problems uncovered by the audit.

Witnesses from the Department and the Board were quick to acknowledge the audit findings and agreed to implement all of the Auditor General’s recommendations. The Committee was informed that several initiatives are now under way and that more are to come. The Committee is also aware that the Legislative Review Advisory Group (the Advisory Group) tasked by the Minister of Citizenship and Immigration to advise her on the best future direction for Canadian immigration laws has reported its findings. Many of the Advisory Group’s recommendations deal directly with issues raised in the audit and are now the subject of extensive consultations.

The Auditor General acknowledged the Advisory Group’s contribution. In addition he suggested that there might be other ways to address the concerns he has raised. The Committee agrees, and presents the following recommendations in the hope that they will contribute to the review and rebuilding effort and that they will lead immediately to efficiencies in the process.

The Department is responsible for determining eligibility for access to the system. The audit reveals several problems at this stage. Rulings are often made in the absence of relevant information. Although genuine refugees often have good cause to be without sufficient documentation, close to 60 percent of claimants lack such documentation. Yet since 1993, over 99 percent of the claims have been judged eligible. If more diligence were exercised at an early stage, strain on the process might be reduced. The Committee therefore recommends:

That the Department of Citizenship and Immigration develop a strategy to make the initial examination of claims more rigorous to ensure that eligibility criteria are met. This strategy must include targets and implementation deadlines.

Of those claiming refugee status in Canada, the majority arrives from a country other than the one in which they claim that they were subject to persecution. In 1989, Parliament gave the Department the authority to deny access to the refugee claims process by claimants arriving from countries known to respect human rights. The audit revealed, however, that this authority has never been used. Ms. Cochrane told the Committee that the government prefers to negotiate responsibility-sharing agreements on a bilateral basis with countries considered to be safe third countries. She indicated that this was a political, rather than an administrative decision. The Committee believes that application of this authority would help relieve pressure on the claims processing system. It therefore recommends:

That the Government of Canada assign priority to negotiation of responsibility sharing agreements with countries considered to be safe third countries.

The results of the audit show clearly that the timely collection and sharing of relevant data presents a challenge to both the Department and the Board. For example, the Auditor General commented that the Department's information systems "could not compile the information needed to account for the resources used in processing refugee claims." (25.38) Information gathered when claims are initially examined could be more complete and relevant, and could be better shared between the Department and the Board. (25.48 – 25.50) The Department has insufficient information to oversee the granting of permanent residence on humanitarian and compassionate grounds. (25.129) It also lacks the information it needs to manage removals effectively. (25.138) The Department, according to the Auditor General, "does not know how many persons are ready for removal." (25.138).

During testimony, departmental officials indicated that the Department has a plan in place to deal with the situation. A new case management system is expected to be in place during the first part of 1999. This system is intended to address the shortcomings identified by the audit. Apart from this, Ms. Cochrane acknowledged that the Department's systems "are old and they don't allow us [the Department] to capture the kind of information that we need."

If the Department and the Board are to manage the claims process efficiently, they need access to data that is timely and complete. This information is also needed to support the accountability of the Department and the Board for their activities related to refugee claims processing. The Committee therefore recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Board develop a strategy to put in place the information systems needed to address gaps identified by the Auditor General. This strategy must include an evaluation of costs and expected benefits as well as targets and implementation deadlines.

The Committee also notes that the Department and the Board are now making a greater effort to share the information that they have gathered and to co-ordinate their efforts in general. These are steps in the right direction and the Committee encourages the Department and the Board to pursue them with renewed vigour.

As indicated, information on the activities of the Department and the Board is needed to support accountability. Yet the Auditor General observed that neither the Department nor the Board have provided complete and relevant information on the processing of refugee status claims in their Estimates documents (*Performance Reports, Reports on Plans and Priorities*). The Committee believes that the quality of this information must be improved and notes that the Department and the Board have agreed to do so. Accordingly, the Committee recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Review Board provide information on their activities related to refugee status determination in their annual *Performance Reports*. This information must be based on a set of clearly articulated performance measurements and emphasize results rather than process.

The Committee shares the concerns of the Auditor General with regard to the appointment of members to the Board. In order to make decisions that are both fair and timely, Board members must have sufficient experience with the system. The audit shows that in the recent past, terms of appointment have been relatively short and that there has been a high turnover among members. This results in low productivity and helps add to the backlog of unprocessed claims. Additional costs are also incurred as the result of the need to train new members. Ms. Mawani indicated that longer terms are helpful to the Board. The Committee notes that recently, the terms of appointment have been longer and turnover has been reduced. Because it is important to maintain a workable level of expertise on the Board, the Committee recommends:

That the government increase the length of appointment when it renews the terms of members of the Immigration and Refugee Review Board. In particular, the government should take past performance into consideration when it re-appoints members for longer terms.

Under existing legislation, hearings at the Board can take place with only one member present provided the claimant has consented. According to the Board's *Performance Report* for the period ending 31 March 1997, single-member hearings, with consent of the claimant, grew from 9 percent of all hearings in 1995-96 to 21 percent in 1996-97. Elsewhere in the *Report*, the Board indicates that the increased use of single-member panels contributed to the Board's productivity gains during 1996-97. The Committee believes that pending any possible legislative change, this avenue offers the potential for added efficiencies and therefore recommends:

That the Board actively explore ways in which to increase the number of hearings that are held with one member present.

The Committee is also concerned that the Board may not have sufficient resources to carry out its mandate. Ms. Mawani testified that with a steady complement of members (currently 169) and a yearly intake of 25,000 claimants, the Board expects that its processing times will be eight months by fiscal year 2000 – 2001. She projected that the pending caseload would be 19,000.

Mr. Thibault indicated that with additional personnel, processing delays would be reduced. In his Report, the Auditor General indicated that the United States and the Netherlands have substantially increased staff in order

to reduce backlogs and abuses of the system. (25.14) The Committee believes there is merit in studying the staffing levels for the Board and recommends:

That the Immigration and Refugee Review Board review its staffing requirements in order to determine the increased efficiencies that would be produced through the appointment of additional members beyond its current complement.

The audit's finding that the Department has difficulty in carrying out removals is troubling. In his Report, the Auditor General indicated that of the approximately 31,200 claimants ordered removed between 1993 and 1997, only 22 percent confirmed that they had left the country. Furthermore, during testimony he told the Committee that at the end of his audit, the Department was able to confirm the departure of only 4,300 of the 19,900 persons who were to have left Canada.

While improvements in the collection and management of data referred to earlier should assist the removal effort, more needs to be done. Ms. Cochrane told the Committee that the Department has developed a comprehensive removal strategy. However, this strategy is only effective to the extent that it is implemented and decisions within its framework taken promptly. The Committee therefore recommends:

That the Department of Citizenship and Immigration make specific reference to actions taken and the results obtained under its comprehensive removal strategy in its *Performance Report* for the period ending 31 March 1998, and annually thereafter.

As noted, proposals to reform Canada's immigration policies, including the processing of refugee claims, are now under close scrutiny. Fundamental change to the way in which claims are processed is likely. Given the complexity of the issue and the challenges facing the Department and the Board, it is vital that the transition between the current system and a new one be carefully and thoughtfully managed. The Committee therefore recommends:

That the Department of Citizenship and Immigration and the Immigration and Refugee Board together develop a strategic plan to manage the transition period between the current refugee claims processing system and any new system that may be implemented. Such a plan should aim, among other things, to limit any negative effect upon efficiency and effectiveness that such a transition may produce.

Lastly, the Auditor General informed the Committee that no one in the federal government monitors the overall progress of claims. He also indicated that there is no information provided to Parliament on interdepartmental performance in processing refugee claims. These are shortcomings that should be corrected. The Committee therefore recommends:

That the government create a mechanism for monitoring the overall progress of refugee claims and reporting interdepartmental performance in claims processing to Parliament.

Conclusion

While the audit revealed problems with the claims processing system, it is important to note that Canada has gained world-wide recognition for its refugee protection program. The Committee also recognizes the dedication

and hard work of those currently operating the system who are committed to its goals and effectiveness. Nevertheless, it is important that shortcomings be addressed and past successes be improved upon for the future. It is also important that Canadians have confidence in the system and that the system treats claimants fairly and with compassion.

The Committee is confident that with measures taken following consultation on the Advisory Group's report and with the adoption of the Committee's recommendations and those of the Auditor General, improvements to the processing of refugee claims will occur and the confidence of Canadians assured.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

Dissenting opinions of the Official Opposition and the Bloc Québécois are appended to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 15, 18 23, 28 and 30)* is tabled.

Respectfully submitted,

John Williams

Chair

Dissenting Opinion of the Official Opposition for the Standing Committee on Public Accounts

Pursuant to Standing Order 108(3)(e), the Official Opposition Members of the Standing Committee on Public Accounts have the honour to present their Dissenting Opinion as an addendum to:

NINTH REPORT

It is the opinion of the Official Opposition that the Report of the Standing Committee on Public Accounts is not representative of the opinions and recommendations of the entire Committee, but rather that of the Government members.

Introduction

“The current system is open to abuse and, in general, does not provide swift protection to those who really need it.”¹

The purpose of this report is not to delve into partisan debate over the findings of the Auditor General (AG), but rather to use these findings to better expedite those who are in genuine need of Canada’s protection. It is the opinion of the Official Opposition that this objective was adhered to in the broad context of the Committee Report. However, in instances where constructive analysis and criticism were required, the government members seemed more focussed on damage control and public relations.

The Official Opposition also recognizes that the Standing Committee on Citizenship and Immigration is presently undertaking an in-depth analysis of the Legislative Review Advisory Group’s Report entitled *Not Just Numbers*. Therefore, this dissenting opinion will focus on the broad-based, systemic problems outlined in the AG Report and leave the technical detail to those studying the legislative review.

Receiving Claims

Both the AG and the Committee Report refer to areas of difficulty in receiving refugee claims. The first recommendation, at page 4 of the Committee Report, recommends that the Department “develop a strategy to make the initial examination of claims more rigorous....”

It is the opinion of the Official Opposition that the Government must put an end to the rampant abuse of economic immigrants trying to get into Canada through the refugee system and start accepting more genuine refugees through offices abroad.

¹ Press Release. Office of the Auditor General of Canada. December 1997 – Chapter 25

Further, we believe that the Government should enforce tighter identification standards on those claimants who fail to produce travel documents.² This strategy should also stop those people who have come to Canada through safe third countries like the United States from making claims here.³

The Committee Report notes the importance of Canada's "world-wide recognition for its refugee protection program." The Government members of the committee defeated a motion to insert the following statement after the aforementioned sentence: "Future emphasis should be focussed on the resettlement of genuine U.N. Convention refugees." The Official Opposition feels that this emphasis would better represent the Auditor General's observation that:

*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.*⁴

The Official Opposition implores the Department of Citizenship and Immigration to seek out genuine Convention refugees overseas whose lives are in imminent danger and are without the financial means of finding asylum here in Canada.

Processing of Refugee Claims

The Committee Report recommends increasing the length of Immigration and Refugee Board (IRB) members' terms and reviewing past performance before re-appointments are granted. Although the Official Opposition concurs with this sentiment, we feel that this recommendation does not address the recruitment and selection of members.

The Auditor General stated, "*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.*"⁵

It is the opinion of the Official Opposition that the recruitment and selection of IRB members is inadequate given the responsibilities inherent to the job. There have been some very competent appointments to the IRB; however, in our opinion, these are the exception rather than standard practice. The majority of the appointments made to the Board are based on political patronage, rather than knowledge or experience. In reference to Board members, the Auditor General stated, "*There must never be any doubt about their competence or their independence.*"⁶

² *Report of the Auditor General of Canada – December 1997*, pp. 25-14 – 25-17

³ *Ibid.*, pp. 25-17 – 25-18

⁴ *Ibid.*, p. 25-34

⁵ *Ibid.*, pp.25-18 – 25-19

⁶ *Ibid.*, p. 25-19

The Ministerial advisory committee was created to recommend appointees to the Minister in order to remove any allegations of patronage. The problem that has arisen, as reported by the IRB founder, Mr. Gordon Fairweather, is that non-Liberal recommendations, regardless of credentials, are overlooked in favour of appointing those who also happen to be Liberals.⁷

The Auditor General made the following observation on the handling of failed refugee claims:

*Citizenship and Immigration Canada is having difficulties in 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.*⁸

To this end, the Official Opposition proposes that the Government involve all law enforcement agencies to clean up our deportation mess. As is stated in the majority report, the Auditor General revealed that, of 19,900 removal orders since 1993, only 22% (4,300) of the departures could be confirmed.⁹

Canadians have lost faith in the immigration system due to the Government's rampant patronage, perceived incompetence and inability to remove those who have been ordered to leave Canada.

Conclusion

The Official Opposition holds a fundamentally different view on the Immigration and Refugee Board than the Government. We would replace the patronage-ridden, unaccountable IRB with well-trained immigration officers accountable to Parliament and Canadians.

While we realize that it is not within the Government's best-interest to end the patronage-appointment process, we fail to understand why they seem uninterested in promoting better accountability, effectiveness, and efficiency when discussing the reform of the Board.

A case in point is the Government members' adoption of a motion to remove the word "widespread" from the draft of the Committee report, which had formerly stated, "...the [AG] audit revealed widespread problems with the claims processing system."

This example emphasizes the Government members' mandate of making reference to the Auditor General's recommendations while removing any language which might be seen to damage themselves.

Rather than an educated assessment of the Auditor General's report, the Committee report amounts to a public relations piece for the Board, the Department and the Government as a whole.

⁷ *The Ottawa Sunday Sun*, February 8, 1998

⁸ *Report of the Auditor General of Canada – December 1997*, p. 25-5

⁹ *Ibid.*, p. 25-29

The conclusion of the Committee Report makes brief references to “problems” and “shortcomings” before moving on to recognize “the dedication and hard work of those currently operating the system who are committed to its goals and effectiveness.”

The Official Opposition is committed to representing grassroots Canadians and to restoring their faith in an immigration system that works for them. For this to occur, the Government must recognize and remedy the widespread problems revealed by the Auditor General in several reports, including Chapter 25 of his December 1997 Report.

Dissenting Opinion to the Ninth Report of the Standing Committee on Public Accounts

Respectfully submitted by :

Odina Desrochers, M.P.

René Laurin, M.P.

Despite the lip-service that the Liberal majority report pays to making the Immigration and Refugee Board (IRB) speedier and more efficient in its processing of refugee claims, the Bloc Québécois considers that the problems cited by the Auditor General will remain unresolved unless and until candidates for the Board are chosen for their qualifications rather than their party loyalty.

In 1993 the Liberal Party criticized the Conservatives' political appointments to the IRB, but the Jean Chrétien government is doing exactly the same thing.

Here is the commitment the Liberal Party made in 1993 on Cabinet appointments :

“The Conservatives made a practice of choosing political friends when making the thousands of appointments to boards, commissions and agencies... To fill the vacancies that remain, a Liberal government will review the appointment process to ensure that necessary appointments are made on the basis of competence.” (Red Book, p. 92)

The reality, since the Liberals came to power, has been instructive. They have never stopped making political appointments to the IRB.

The Bloc Québécois has on many occasions called on the Liberal government to introduce an appointment process that would ensure complete impartiality and a selection based on candidates' competence and professional experience.

The last paragraph at page 8 of the majority report could be very timely, as long as the second paragraph at page 4, which deals with general principles, is made more specific. The Bloc Québécois would like the “targets and deadlines” to be defined, with a clear and detailed timetable : this would enable Parliament to really monitor the proposed changes and ensure that they do in fact improve the IRB's processing of refugee claims.

REPORTS TO THE HOUSE

Tuesday, 12 May 1998

Management of the Small Business Loans Program

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 29 of the December 1997 Report of the Auditor General of Canada (*Industry Canada - Management of the Small Business Loans Program*) and the Committee has agreed to report the following:

Introduction

Small businesses constitute the overwhelming majority of all business establishments in Canada and contribute significantly to the nation's economic output and employment.

Lack of financing under reasonable terms and conditions is considered a serious impediment to small business expansion. Consequently, governments in industrialised countries have often played a complementary role to private lending institutions either as direct providers of capital financing or to secure access to financial capital through loan guarantees, usually with the objective of promoting economic growth and employment.

In recognition of the contribution of small businesses to the dynamism of the Canadian economy, the Federal government delivers several programs designed to promote and stimulate small business development and growth. The *Small Business Loans Act* (SBLA) program, administered by Industry Canada and delivered through private financial institutions, is one of these federal programs.

Recent amendments to the *Small Business Loans Act* have resulted in significant increases in SBLA loan activity and in levels of claims to the Federal government. This sudden surge in program lending activity and claim levels prompted the Auditor General to audit the SBLA program management.

Acknowledging that the associated cost incurred by the SBLA program can become substantial to the Federal Government, the Committee decided to examine Chapter 29 of the Auditor General's December 1997 Report (*Industry Canada - The Management of the Small Business Loan Program*). Accordingly, on February 19, 1998, the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Richard Flageole (Assistant Auditor General), and Mr. Harry A. Ruthnum (Principal, Audit Operations) from the Office of the Auditor General. Mr. Kevin G. Lynch (Deputy Minister), Mr. Peter Sagar (Director General, Entrepreneur and Small Business Office), and Ms. Marie Josée Thivierge (Director, Strategic Planning and Corporate Services) represented Industry Canada.

Background

Established in 1961, the *Small Business Loans Act* (SBLA) encourages private sector lending institutions to make loans of up to \$250,000 to small businesses for the purchase or improvement of land, buildings and equipment. In case of borrower default, the program reimburses the lender 85 percent of the net amount of the loan. The maximum loan loss that can be refunded to individual lenders is limited to 10 percent of total outstanding registered loans.

In 1993, Parliament approved important changes to the SBLA program that simultaneously broadened eligibility requirements, increased maximum loan amounts from \$100,000 to \$250,000, increased the permissible financing from 80 percent to 100 percent for equipment and 90 percent for land and buildings and reduced the personal guarantee requirements. Within two years of these legislative changes, lending activity soared eight-fold from an annual average of \$500 million to \$4.4 billion dollars. Starting with the same period, claims on defaulted loans increased considerably. Because loans may be repaid over a period of ten years and claims may be submitted for a further three years, the impact of loan losses will continue to be felt for a considerable period of time. According to the Auditor General, the program will incur an estimated net loss of \$210 million for loans issued between 1993 and 1995. Since 1993, some 177,000 new loans have been guaranteed for a value of approximately \$11.2 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.

In response to increasing risk and cost, legislative changes introduced effective 1 April 1995 modified SBLA program elements to encourage full cost recovery. The amendments were: introduction of an annual fee of 1.25 percent charged to the lender and based on the outstanding balance of loans; a reduction of insurance coverage from 90 to 85 percent of loan value, and the percentage of available financing was decreased from 100 percent to 90 percent (for loans made after 31 December 1995). As a result of these changes, the dollar value of loans issued under the program has dropped into the range of \$2 billion annually. The Auditor General is uncertain whether the objective of full cost recovery is achievable under the present fee structure and loss-sharing ratio, nor if it is at all compatible with the program's fundamental goal of assuring that loans made under the program are complementary to existing lending.

New lending under the Program was supposed to end on 31 March 1998, however Bill C-21, which was passed in the House of Commons on 17 March 1998, extends the application of the *Small Business Loans Act* to 31 March 1999. This one-year extension is to allow Industry Canada to carry out a review and implement changes to the SBLA program.

Observations and Recommendations

The Committee learned of three principal concerns expressed by the Auditor General regarding his review of the *Small Business Loans Act* program. The Auditor General focussed on the lack of clear definition about expected results, weaknesses in the management and delivery of the program, and the provision of information to Parliament, particularly in terms of program objectives, achieved results and job creation data.

Apart from the very broad objective of increasing the availability of loans to small enterprises, the SBLA program lacks a clear statement of objectives and expected results by which one can assess the program's performance and achievement of its stated goals. The SBLA program objective is stated in very general terms, that is "to increase the availability of loans for establishing, expanding, modernising, and improving small business enterprises". The stated objective does not specify how these goals are to be achieved. It is worth noting that when program delivery is delegated to third parties (i.e. private lending institutions) program managers have less

discretion in influencing the direction and scope of the program. Nevertheless, program managers would benefit from a more precise definition of expected results that is articulated within a framework of broad legislated objectives. Clearly defined performance criteria are a prerequisite for sound program design, especially in a context of continuous legislative or administrative changes. Therefore the Committee recommends:

That the review undertaken by the Department of Industry develop a set of clearly defined statements of performance and expected results for the SBLA program, and also establish a number of key performance indicators to help evaluate its progress in achieving the stated goals.

The Auditor General is particularly concerned about the degree of the program's loan incrementality, that is the proportion of loans that would not have been made in the absence of the program. In the past five years, the Department commissioned several studies to determine the incrementality of SBLA loans. A 1994 study indicated that between 30 to 40 percent of SBLA loans were non-incremental. Another study completed in 1996 indicated that 46 percent of SBLA loans competed directly with private sector financing. Since the program's objective is to increase the availability of loans to small enterprises beyond that which would be normally available from private lenders, the Committee believes that it is important to assure the complementary character of SBLA loans in order to avoid waste of scarce capital resources. It therefore recommends:

That the program review establish clear target levels of incrementality for its SBLA loans.

The Auditor General has also noted that while the SBLA program underwent many major changes since its inception in 1961, it is still directed toward the financing of capital assets (land, buildings and equipment). While this type of financing is suitable in an economy dominated by the manufacturing sector, it may not be as suitable in a service economy, particularly for knowledge based industries (KBI) such as computer or software based businesses. Recently, private sector financial institutions have introduced new products and services directed to respond to current financial needs of small business. The SBLA program may require amendment to address any gaps in the private financing of small businesses. Therefore, the Committee recommends:

That during the current review Industry Canada identify gaps in the private financing of small enterprises and redesign the SBLA program in order to supplement current small business financing needs in the market areas where it is determined that government assistance would be beneficial.

Following the 1993 program amendments, a significant increase was observed in both lending activity and in the level of claims on borrower default. As a result of this surge in loan activity and cost, a policy of full cost recovery was implemented after 1 April 1995. This new policy introduced certain changes to elements of the program, such as a decrease of the loan-loss ratio from 90 percent to 85 percent and saw the imposition of a 1.25 percent annual administration fee charged to the lending institution on the average amount of loans outstanding. Industry Canada projected that these measures would eventually lead to full cost recovery over a 10-year period. However, both the Auditor General and the Department have recently reviewed the program's loan guarantee portfolio and observed a significant increase in the proportion of riskier loans and a rise in rates of defaults that are occurring at earlier stages in the life of the loans. The Auditor General feels that program managers should take into account the impact of a riskier portfolio and the business cycle when making default rate projections. The Auditor General believes that under the current fee structure and loss sharing ratio, it is uncertain that full cost recovery will be achieved. As a result, the Committee recommends:

That the Department closely monitor any developments in the performance of its guaranteed loan portfolio that might prevent it from achieving full cost recovery and that it take corrective action at an early stage.

The Auditor General recommended in paragraph 29.52 of his Report that the Department needs to further develop systems and procedures to forecast the future performance of its guaranteed loan portfolio. The Committee heard the testimony of the Department's Director of Strategic Planning and Corporate Services, Ms. Marie-Josée Thivierge, regarding the progress in the development of the required systems and procedures to forecast program performance. Noting the progress already achieved, the Committee therefore recommends:

That the current review establish systems and procedures to forecast program performance for portfolio management and to take early corrective action if necessary.

The program is structured in such a way that the responsibility of credit risk management and compliance to SBLA provisions are delegated to the lending institutions. The expectation is that lenders will ensure that all loans made under the program are in compliance with the SBLA eligibility requirements and conditions and that lending decisions under the program are made with the same due care and diligence as with non program loans. The Department itself obtains assurance of the quality of credit risk and compliance to the Act by focussing on claims submitted for payment.

The Auditor General is concerned whether the systems and procedures in place are sufficient to ensure that loans made under the program comply with SBLA provisions. He examined the lenders' loan files and noted that in certain cases some files contained insufficient information to perform a thorough analysis of credit risk. In other instances, financial institutions had charged, contrary to the Act, extra administration fees for granting loans under the program. Additionally, it was observed that in some other cases the Department did not request full and complete information on the loan files when assessing a claim. In such cases, there is greater risk of accepting claims that may not be in compliance with the provisions of the Act. To minimise the risk associated with non-compliant loans, the Committee recommends:

That the Department obtain and review all bad loan files to ensure lender's compliance with the provisions of the Small Business Loans Act.

The Department told the Committee that it acknowledges certain of the Auditor General's concerns about the compliance of financial institutions to the provisions of the Act and assured the Committee that it will address these concerns in its upcoming review. However, the Department felt that the processes and systems already in place were sufficient to detect most irregularities and that the potential rejection of a claim request was deemed a sufficient deterrent to ensure that lenders apply due care and diligence in making loans under the SBLA program. Nevertheless, the Committee feels that the Department could exert more effort to further reduce the risk of accepting non-compliant loans by increasing its monitoring of financial institution's lending practices. Therefore the Committee recommends:

That in order to ensure better lenders' compliance with SBLA provisions , the Department implement measures to increase monitoring of financial institutions lending practices such as securing better access to lender's loan files and undertaking sample audits of lender's loan portfolio.

The Auditor General's sample audit of the lender's loan portfolio also identified cases where related borrowers were able to obtain loan amounts far in excess to the \$250,000 limit per business. In one case, 23 related borrowers managed to obtain more than \$4 million in loans. While these practices are contrary to the intent of the Act, the Auditor General noted that there are currently no provisions under the SBLA to prevent a group of entities with substantial 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 related corporations. The Auditor General stressed the importance

of clarifying this issue in order to ensure that the Program meet its intent of providing financial assistance to small enterprises within acceptable level of risk exposure to the government. The Department responded to this question by sending in a Notice to Lenders in May 1996 to address this specific issue and is proposing to introduce amendments to the Act during its upcoming review. At the same time, the Department feels that the actions it has already taken have sufficiently clarified the Act's provisions so that there is no longer any room for misinterpretation by lending institutions regarding access to loans by related entities. The Committee recognises the Department's current efforts to resolve this issue, and urges it to continue to take steps in removing all ambiguity in the interpretation of the provisions of the Act. Therefore, the Committee recommends:

That the Department use the opportunity offered by its program review to further clarify the provisions in the SBLA by providing amendments to the Act with regards to loans to related entities.

The Department reports to Parliament on the *Small Business Loans Act* program primarily through Part III of the Estimates and the Minister's annual report. The Auditor General assessed these documents in terms of their information content and concluded that better data could be provided especially in the areas of performance indicators and job creation data.

While these documents do provide some useful information in describing the context under which the SBLA program operates, the Auditor General concludes that they do not contain enough information to assess the program's ability to attain its stated objectives or if it is managed efficiently.

The Auditor General feels that the absence of clear program objectives hinders the Department's ability to find suitable performance indicators to assist in the evaluation of the SBLA program. Given the stated goals of incrementality and full cost recovery, proper evaluation would require information on revenues, administrative and claims expenditures, and a provision for loan losses. The information should also be presented on accrual basis. In 1997, the Department implemented a new information system which would provide additional information on program results such as lending activity by types of lenders, by provinces, by size of business enterprises, as well as claim activity levels, management program costs and revenues, and Minister's liability on outstanding loans. The Committee urges the Department to continue efforts in this vein, and thus recommends :

That the Department use the opportunity provided by the program review to establish a comprehensive system of performance reporting to Parliament including a set of performance indicators.

The Department also reports on the number of jobs created as a result of the program. In its 1995-96 Annual Report, the Department reported that 81,600 jobs had been created as a result of the program. The Department gets job creation data through a survey of loan guarantee registration forms that is prepared by lending institutions. The Auditor General finds this approach of reporting job creation as being too simplistic because the information on jobs created is based on the borrowers own labour projections which might overstate the number of jobs actually being created. The Auditor General cites economic studies undertaken by the Department itself which suggest that the actual employment gains resulting from the SBLA program is far smaller than the ones indicated in the annual reports. The Auditor General feels that the Department should apply a more rigorous methodology to properly evaluate the employment impacts of the SBLA program. Also, there are questions raised about placing too much emphasis on employment growth as a justification of the SBLA program. Loans that can augment small business performance such as the introduction of new technology can improve its competitive position or cost structure but can also result in temporary job losses as new technology or processes displace workers. The Committee shares the Auditor General concerns and therefore it recommends:

That in the current review, the Department re-examine its existing systems and procedures in order to develop a more rigorous methodology in evaluating the job impacts of the SBLA program.

Conclusion

The *Small Business Loans Act* program provides assistance to the small business sector in Canada but the audit revealed certain shortcomings in its design, operations and reporting to Parliament and these need to be addressed. The Program, scheduled to terminate in 31 March 1998, was given a one year extension in order to complete a thorough review of its stated objectives, designs and operations.

The Committee is confident that the adoption of its recommendations and those of the Auditor General, will assist the current review of the *Small Business Loans Act* program, and that improvements will occur and assure better assistance to small enterprises throughout Canada.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 19 and 30)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Correctional Services - Custody of Inmates

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

ELEVENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 35 of the December 1997 Report of the Auditor General of Canada (*Follow-up of Recommendations in Previous Reports - Correctional Services - Custody of Inmates*) and the Committee has agreed to report the following:

Introduction

In his 1994 Report, the Auditor General presented the results of his audit of Correctional Services Canada's (CSC or the Service) activities with relation to the custody of inmates. The Standing Committee on Public Accounts held hearings on the audit results and presented its 13th Report containing observations and recommendations to the House of Commons on 15 June 1995. Correctional Service Canada's response to both the Auditor General's Report and the Committee's Report was generally positive.

Subsequently, the Auditor General conducted a follow-up review of the progress made by CSC in implementing both his and the Committee's recommendations. The results of this follow up were presented in Chapter 35 of his December 1997 Report.

The way in which CSC manages custody of inmates in Canada's penitentiaries has a profound impact on Canadian society and involves the safety of individuals, communities, those who work in the prison system, and those who are incarcerated within it. As a consequence of this and of Committee's past interest, the Committee decided to examine the results of the Auditor General's follow-up review. Accordingly on 2 April 1998 it met with Mr. L. Denis Desautels, the Auditor General of Canada, Dr. Maria Barrados, Assistant Auditor General, and Mr. Robert Chen, Director of Audit Operations, from the Office of the Auditor General. Mr. Ole Ingstrup, Commissioner, and Ms. Lynn Balice, Director, Ministerial Liaison, represented Correctional Service Canada.

Observations and Recommendations

The Committee learned that Correctional Service Canada has carried out a number of initiatives in response to the Committee's recommendations and those of the Auditor General. In terms of accommodation planning, the Service's response was appropriate. In accordance with recommendations, it has begun to use cost-benefit analysis when it evaluates future accommodation projects. It now incorporates double-bunking and shared-accommodation strategies in its accommodation planning. It has also appointed a full-time senior executive responsible for all functions that are related to accommodation. The Committee welcomes the progress made in these areas.

Progress with regard to security classification, however, has not been all that was hoped for. Security classification is a vital part of what the Service does and takes place in two steps. When an offender is taken in to the system, he or she is assessed using the Service's Custody Rating Scale (CRS) to determine level of risk they pose to security. Subsequent to this initial assessment, the inmate is reclassified on an annual basis using the Service's Security Classification Review.

The information generated by these assessments is used to assign the inmate to either a maximum-, medium-, or minimum-security facility. If the assessment is not exact, the inmate may be assigned to an institution with a higher degree of security than is necessary. This results in higher incarceration costs. If the reverse happens and a high-risk offender is assigned to a lower-security institution, then public safety is put at risk. Occasionally, an inmate may be deliberately accommodated in a facility that does not match his or her assessment. This is known as an 'override' and may happen for a legitimate reason such as a desire to house the inmate close to his or her family. At other times, however, overrides can occur without a legitimate reason. When overrides exceed 15 to 20 percent, it is commonly agreed that management must decide whether the method of security assessment needs to be changed or if staff need additional training.

Although CSC has made improvements, the Auditor General reported that a 1996 study by the Service found a 26 percent override rate. Only about half of the overrides were for legitimate reasons. Despite the Committee's recommendation that the Service monitor overrides regularly, CSC was unable to report the number of and reasons for overrides until December 1997. Mr. Ingstrup told the Committee that in its first monitoring report covering the period ending 22 February 1998, the Service found that 53% of the time, its officers were overriding the Scale to place inmates in medium –security institutions when they had been classified as maximum-security.

The Commissioner argued, however, that the high rate of overrides occurred because the Custody Rating Scale did not reflect reality. Correctional staff were thus obliged to override some of the ratings produced by the Scale in order to ensure that inmates were assigned to the correct facilities. No increase in the rate of escape, he asserted, proved that decisions to override the Scale were appropriate. In addition, the Commissioner asserted that overriding the Scale had not resulted in problems in the correctional institutions. Based on these conclusions CSC is adjusting the Scale to bring it into line with reality and expects to complete this work sometime in 1998.

In addition, the Service estimates that it will only be able to implement new, more objective, reclassification methodology — currently being tested — by the end of 1998. As a consequence of the changes being made to the CRS and the reclassification instrument, CSC estimates that it should be able to reduce overrides to a rate of 15 percent sometime in 1998.

Mr. Ingstrup told the Committee that delays in implementing these changes were unacceptable but declined to offer any explanation. In light of the role played by classification in promoting public safety and keeping costs within reason, the Committee finds these delays regrettable. It therefore recommends:

That Correctional Service Canada adhere to the schedule it has established for adjusting its Custody Rating Scale and fully implementing a quantitative, objective reclassification instrument and keep the Committee advised of the progress being made in both areas.

Furthermore, the Committee recommends:

That Correctional Service Canada regularly monitor the application of its classification instruments and the results generated. In particular, the Service must monitor the use of overrides and report the results to Parliament;

That Correctional Service Canada periodically revise its classification instruments in order that they reflect actual experience;

That Correctional Service Canada establish and make public a deadline for attaining its target override rate of 15 percent; and

That Correctional Service Canada regularly consult with and train its staff regarding the use of the Custody Rating Scale, the reclassification instrument, and the valid use of overrides.

In its 13th Report, the Committee expressed its concerns about double bunking. The Committee was therefore pleased to hear the Commissioner state clearly that double occupancy (which includes double bunking) is ‘inappropriate as a permanent accommodation measure within the context of good corrections.’ Contrary to what might be assumed, costs associated with this form of accommodation are higher — not lower. For example, Mr. Ingstrup agreed that double bunking generally requires increased staffing. This may also result in the reallocation of funds needed to support programs that facilitate the movement of inmates to lower – security — and thus lower-cost — institutions. If transfers are delayed because program requirements have not been met, costs are kept higher than need be. It therefore makes sense in terms of both rehabilitation and cost to eventually eliminate this practice.

Mr. Ingstrup told the Committee that CSC hopes that by implementing some of the Auditor General’s other recommendations the incarcerated population will be lower thus reducing double occupancy or double bunking from the current level of 25 percent. During testimony he indicated that the Service hopes to attain a reasonable level of double occupancy and ‘potentially get rid of double bunking altogether.’

The Committee notes that CSC is currently reviewing its accommodation policy and recommends:

That Correctional Service Canada establish, within the context of its review of accommodation policy, what constitutes a reasonable level of double occupancy, that it establish an estimated date for ending the practice of double bunking, and that it clarify its policy on shared accommodation.

Conclusion

At the end of his testimony, the Auditor General indicated that he was quite pleased with the actions taken by Correctional Service Canada. The Committee acknowledges that progress has been made in addressing the concerns and recommendations that it made in 1995. There are, however, several areas in which progress has not been as complete or timely as the Committee would have liked. The Committee expects that Correctional Service Canada will meet the commitments that it has made and will finish the task of improving security classification and accommodation policies. This will result in a penitentiary system that is safer, more efficient, and better able to achieve the correctional goals that have been set for it.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 26 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Revenue Canada and Department of Finance Understanding Changes in Tax Revenues: GST

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

TWELFTH REPORT

The Standing Committee on Public Accounts has considered Chapter 32 of the December 1997 Report of the Auditor General of Canada (*Revenue Canada and Department of Finance — Understanding Changes in Tax Revenues: GST*) and the Committee has agreed to report the following:

Introduction

The ability of the Federal Government to fully account for tax revenue fluctuations is critical for the identification of errors and increases its awareness of new economic trends. It also enhances the credibility of the Government's financial reporting to Parliament and improves its ability to forecast tax revenues, budgetary deficits and borrowing requirements.

The Auditor General has observed that monthly Goods and Services Tax (GST) revenues fluctuated significantly over time and with no apparent pattern. It was further noted that GST revenues for the year ended 31 March 1996 turned out to be \$800 million lower than the 6 March 1996 Budget forecast, and \$400 million lower than the previous year's actual revenue. The Auditor General is of the opinion that Revenue Canada and the Department of Finance ought to be better able to understand and explain such fluctuations in tax revenue streams.

Because of the importance to the Federal government of being able to fully account for and explain revenue fluctuations, the Committee decided to examine Chapter 32 of the Auditor General's December 1997 Report. Accordingly, on 17 March 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General), Mr. James Ralston (Principal, Audit Operations), Mr. Scott Milne (Principal, Audit Operations) and Ms. Basia Ruta (Principal, Audit Operations) from the Office of the Auditor General. The following represented Revenue Canada: Mr. Robert A. Wright (Deputy Minister), Mr. Dan Tucker (Assistant Deputy Minister, Finance and Administration Branch), Mr. John Kowalski (Director General, Audit Directorate), Mr. Bill Boston (Director General, Financial Administration Directorate, Financial and Administration Branch), Mr. David Miller (Assistant Deputy Minister, Assessment and Collections Branch), Mr. Brian Brimble (Interim Director General, Operational Policy and Co ordination Directorate, Customs and Trade Administration Branch), Mr. Paul Godden (Interim Director, Program Support Division, Operational Policy and Co ordination Directorate) and Mr. Stephen Rigby (Director General, Corporate Affairs Branch). Mr. Peter DeVries (Director, Fiscal Policy Division) and Mr. Paul-Henri Lapointe (Assistant Deputy Minister, Fiscal and Economic Policy) represented the Department of Finance.

Observations and Recommendations

The Auditor General informed the Committee that the total GST revenues collected for the year ending 31 March 1996 was the \$800 million less than the amount predicted by the 6 March 1996 forecast, and \$400 million lower than the previous year actual revenue. The Auditor General mentioned the Department of Finance and Revenue Canada's attempt to identify the contributing factors responsible for the GST revenue shortfall and concluded that both Department failed to provide a conclusive and adequately documented explanation.

The Auditor General believes the federal government's ability to ascertain the cause (or causes) responsible for revenue fluctuations can be improved if it follows an appropriate five step process for analysing movements in revenue streams. The audit found that the Department of Finance and Revenue Canada did not follow this process to the minimum extent required, nor did they make use of all available data. Some of the unused data were considered unreliable.

The Auditor General also mentioned other items that were affecting the analytical capability such as a need for a better co-ordinated effort within Revenue Canada; the limited amount of information reported on GST returns; and the way Revenue Canada records figures for "GST declared" and "input tax credits".

The Assistant Deputy Minister of the Department of Finance, Mr. Paul-Henri Lapointe, while agreeing with the Auditor General's recommendations for improving the timeliness and the reliability of GST data, nonetheless disagreed with the Auditor's assessment that the analysis was inconclusive and that both Departments failed at carrying out the appropriate analytical process. Finance's analysis pointed to several factors which could have contributed to the forecast variance. First, economic data used for analytical purposes come with considerable time lags and are subject to revisions well after the fact. This alone was estimated to represent \$500 million of the \$800 million GST revenue shortfall. Second, Revenue Canada identified a further \$245 million of the shortfall that was due to bookkeeping adjustments. Finally, other contributing factors identified were time lags between receipt of GST collections and payments of refunds and rebates, and changes in receivables.

In his opening statements, the Deputy Minister of the Department of Revenue, Mr. Robert Wright, did not make any specific statements on GST revenue fluctuations with the exception that the Revenue Canada will continue to collaborate with Finance in the Fiscal Monitor Committee to address revenue analysis issues. When the Committee members questioned Mr. Wright about Revenue Canada's adherence to the five step analytical process, the witness responded that Revenue Canada generally followed the recommended five step process and mentioned an offer to collaborate with the Auditor General towards improving the Department's execution of the analytical process. Revenue Canada's Director General of the Financial Administration Directorate, Mr. Bill Boston, concurred with Mr. Wright's statements, that Revenue Canada substantially, but not fully, followed the recommended process. While the Committee recognises Revenue Canada and the Department of Finance's efforts at fully accounting for revenue changes, it agrees with the Auditor General that closer adherence to the recommended process will enhance each Department's ability to analyse revenue streams. Therefore, the Committee recommends:

That both Departments set an action plan and timetable in order to meet with the Auditor General to find ways of ensuring that the five step analytical process is fully and thoroughly adhered to and carried out.

The Auditor General mentioned in his report on the importance of improving the reliability and the timeliness of the data, and making better use of them would improve Revenue Canada and Finance's ability to analyse GST movements, it may not be enough. Additional registrant information might be required (32.35). The Assistant Deputy Minister of the Department of Finance, Mr. Paul-Henri Lapointe, agreed with the need to improve

the reliability and timeliness of tax data but this requirement had to be balanced against the need to minimise any additional burden to the tax registrant. Committee members expressed similar reticence at imposing additional cost and administrative burden to registrants. Mr. Shahid Minto, Assistant Auditor General, agreed with the concerns expressed by the Committee and proposed one way of obtaining supplementary information without adding to registrant burden. The method consists of simply amending the GST return form so that the information contained in the working copy is transferred to the detachable portion of the form that is submitted to Revenue Canada (Exhibit 32.3) This leads the Committee to recommend:

That both Departments continuously explore ways of improving reliability and timeliness of revenue information with a equal concern of avoiding undue cost and administrative burden to tax registrants.

In a related question, the Committee enquired if Revenue Canada had enough information to administer the GST. In response, the Department's Deputy Minister, Mr. Robert Wright, assured the Committee that it had sufficient data to administer the GST and would like enough information to carry out cross checks to improve data reliability but did not recommend asking for additional information from taxpayers for purely analytical purposes. Mr. Wright went on to say that the current re-engineering of processes at Revenue Canada, which includes the standardisation of accounting systems, expected to be concluded by year 2002, and the move towards accrual basis of accounting, will provide further opportunities to improve monitoring and analysis of revenue streams. The Committee therefore recommends:

That both Departments in co-operation with the Auditor General, investigate ways to obtain more information on GST collection without imposing additional cost and administrative burden to tax registrants. And that Revenue Canada complete its transition towards standardised accounting systems and accrual basis of accounting as a further means of verification and validation of revenue data.

The Committee also enquired about the level of co-ordination between Finance and Revenue Canada in terms of analysing GST revenue fluctuations and whether both Departments has similar co-ordination arrangements for other revenue streams. The Department of Finance's Deputy Minister, Mr. Paul-Henri Lapointe, assured the Committee that both Departments work closely together in analysing *all* revenue streams through their Fiscal Monitor Committee. Furthermore, there are regular consultations with their provincial counterparts to assess the current fiscal situation of the provinces as well to identify events that might have serious impacts on national revenue. In light of this, the Committee recommends:

That both Departments seek further opportunities to better co-ordinate their efforts to improve their capability to analyse all revenue streams and also seek to improve the consultation process with the provinces to better identify issues that may be relevant in analysing national revenue streams.

Conclusion

The Committee shares the concerns expressed by the Auditor General concerning Revenue Canada and Finance's ability to thoroughly analyse GST revenue fluctuations. While recognising the continued efforts of both Departments in explaining changes to revenue streams, it is felt that further action on their part could be pursued in order to assure the completeness of the analysis. Particularly, both Departments should follow more closely the five-step process the Auditor General recommended for analysing GST revenue movements. Moreover, to the extent that revenue analysis is still hampered by unreliable and untimely data, Finance and Revenue Canada should therefore continue to develop better processes in obtaining, verifying and validating the required information.

The Committee appreciates the forthrightness of the witnesses from the Departments of Finance and Revenue, and commends them on their willingness to take action on the concerns and recommendations of the Auditor General.

The Committee is confident that the adoption of its recommendations and those of the Auditor General will assist Revenue Canada and Finance in its efforts to improve their joint ability to fully analyse revenue fluctuations.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 22 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Friday, 15 May 1998

Revenue Canada The Financial Management Regime

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

THIRTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 31 of the December 1997 Report of the Auditor General of Canada (*Revenue Canada - The Financial Management Regime*) and the Committee has agreed to report the following:

Introduction

Few federal organisations can compare with Revenue Canada in terms of size and range of financial transactions. With a workforce of over 40,000 employees in approximately 800 offices across Canada, its activities support most federal government programs and expenditures, and via transfer payments, provides funding to assist provincial governments in delivering their programs and meeting their commitments. On a daily basis, Revenue Canada collects about \$850 million in taxes and disburses \$425 million in the form of various refunds and credits. In the execution of its mandated responsibilities Revenue Canada must perform innumerable financial transactions and follow multitudinous accounting procedures across the width and breadth of its organisation.

Given the enormous size of the financial operations involved, minor discrepancies, errors and missed opportunities at correcting inefficiencies can result in potentially significant and cumulatively huge amounts of foregone tax revenues. Given the scope of its activities and the importance of Revenue Canada's ability to meet its mandated responsibilities, the Department must show a clear and strong commitment to effective financial management and control of expenditures, revenues and assets.

Because of the crucial importance of an effective financial management regime to the integrity and effectiveness of Revenue Canada operations, the Committee decided to examine Chapter 31 of the Auditor General's December 1997 Report. Accordingly, on 17 March 1998 the Committee met with Mr. Denis Desautels (Auditor General of Canada), Mr. Shahid Minto (Assistant Auditor General), Mr. James Ralston (Principal, Audit Operations), Mr. Scott Milne (Principal, Audit Operations) and Ms. Basia Ruta (Principal, Audit Operations) from the Office of the Auditor General. The following represented Revenue Canada: Mr. Robert A. Wright (Deputy Minister), Mr. Dan Tucker (Assistant Deputy Minister, Finance and Administration Branch), Mr. John Kowalski (Director General, Audit Directorate), Mr. Bill Boston (Director General, Financial Administration Directorate, Finance and Administration Branch), Mr. David Miller (Assistant Deputy Minister, Assessment and Collections Branch), Mr. Brian Brimble (Interim Director General, Operational Policy and Coordination Directorate, Customs and Trade Administration Branch), Mr. Paul Godden (Interim Director, Program Support Division, Operational Policy and Coordination Directorate) and Mr. Stephen Rigby (Director General, Corporate Affairs Branch). Mr. Peter DeVries (Director, Fiscal Policy Division) and Mr. Henri Paul Lapointe (Assistant Deputy Minister, Fiscal and Economic Policy) represented the Department of Finance.

Observations and Recommendations

The Committee learned from Auditor General that Revenue Canada's financial management regime was basically sound with some areas of strength and no areas of neglect. It was also noted there were still some areas in need of improvement. Revenue Canada scores well in aspects of strategic planning and enhancing management accountability, but many of its financial systems are weak and require considerable modernising.

The Auditor General's Report examined Revenue Canada's ability to meet its two key fiduciary responsibilities: to ensure the prompt deposit of taxpayer remittances, and to report tax revenues to central agencies.

Prompt bank remitting is important because it avoids paying interest on short-term borrowing or can earn interest by investing surplus funds. The Auditor General noted discrepancies (31.27) between revenue streams in terms of deposit remittance rates. The unevenness in remittance rates is in part due to some revenue streams having provisions for mandatory bank remittance (e.g. source deductions and domestic GST), while other tax revenues (e.g. Customs payments, GST on imported goods, excise levies and duties) are not legally required to be deposited in financial institutions. An additional reason for differences in remittance rates is that not all revenue streams have legislative provisions imposing financial penalties (31.27) on those tax filers who fail to remit tax monies to financial institutions.

Since the administrative consolidation of Customs and Excise with Taxation, Revenue Canada has been active in suggesting legislative changes to harmonise legal provisions across all revenue streams. Proposals for harmonising are in the hands of the Department of Finance. The Committee agrees with the Auditor General that the harmonisation of mandatory bank remittances provisions across all revenue streams will improve the Revenue Canada's cash management and ensure fairer and more equitable treatment of all taxpayers. The Committee therefore recommends:

That legislative amendments be implemented to ensure all revenue streams are subject to the same mandatory bank remittance provisions. In addition, that financial penalty provisions for failure to remit tax monies be applied across all revenue streams.

The Auditor General stated that there is a strong incentive to ensure timely and prompt remittance of tax receipts because it could result in millions of dollars in additional interest revenue or, alternatively, in savings on interest expense for the government each year. The Auditor General's Report noted (31.31) that while Revenue Canada has an established policy for all its offices and ports of scheduling bank deposits if the total daily receipts exceed \$500 dollars, the policy remains vague in terms of timeliness of bank remittance. The Audit revealed that Customs offices have no clear expectation of results for the timeliness of deposits (31.31). As for the rest of the Department, according to the Auditor General, there is a policy of remitting tax monies within 24 hours and maximisation of same day deposits but no performance targets are provided for same day deposits.

The Auditor General assessed Revenue Canada for its timeliness of deposits and found the remittance performance generally satisfactory (31.33) with the majority of tax receipts being promptly deposited on the next business day. But the performance varied considerably by type of revenue stream, by office and by month (31.34). There exist considerable opportunities to improve the promptness of depositing. The Department agrees with the Auditor General's findings and has already taken measures to reinforce effective cash management both at its headquarters and at the regional levels. The Department's Deputy Minister, Mr. Robert Wright, told the Committee that the Department has recently introduced a standard of 100 percent of all remittances within 24 hours and that all significant exceptions will be reported to the responsible assistant deputy minister. Further, Revenue Canada has taken steps to clarify performance requirements to ensure that no ambiguity remains as to the interpretation of

performance standards for same day depositing. The Committee shared the concerns expressed by the Auditor General with regards to the timeliness of depositing tax receipts and also acknowledged the Department's current efforts to correct this and thus recommends:

That the Department complete and follow through with all haste and diligence its new policy of full and complete remittance of tax monies within 24 hours and proceed with the clarification of the interpretation of performance standards for same day remittances.

The Auditor General informed the Committee that financial management systems, procedures and practices in place at Customs and Excise did not efficiently support the \$18 billion in cash receipts it processed annually (31.37). The Auditor General observed no same day deposits for the Customs office included in the sample audit (31.35). Customs has yet to clearly establish a standard of performance for promptness of its deposits. The Audit found Custom's national deposit system archaic, labour intensive, slow and prone to error. Departmental witnesses agreed with the audit report that Customs cash management systems and procedures had many shortcomings. Mr. Rob Wright informed the Committee about temporary measures Revenue Canada recently introduced to improve Customs' cash management performance. Further, Revenue Canada intends to completely rebuild its cash management systems as part of its five-year plan to re-engineer all its business processes, specifically the Department's plan to move Customs processes to the new Standardised Accounting Systems by year 2002 (31.30, 31.36, 31.39). The Committee therefore recommends the following:

That Revenue Canada introduce effective bank remitting system for Customs and also update Custom's systems in order to improve its ability to process large amounts of cash receipts. That these changes be ready to be implemented by the time Revenue Canada completes its re-engineering of all its business systems by year 2002.

The Auditor General found four areas of weakness (31.44) in Revenue Canada's revenue reporting systems and practices: systems, standards of performance, reconciliation, and analysis. The existing systems supporting the reporting of revenues are inefficient, disconnected and cumbersome (31.45). In order to obtain transaction and process information one must go to program branches in order get the required data from various feeder systems. The process of data collection is archaic, slow and labour-intensive which make even simple bookkeeping operations difficult to perform. In his Report, the Auditor General stated (31.45) that there is an urgent need to replace the existing feeder systems with automated data inputting systems. The Auditor General noted (31.46) Revenue Canada re-engineering efforts to remove inefficiencies caused by the disconnectivity of the current system by proposing to integrate client account information with information for assessing and for revenue reporting. The re-engineering also proposes to include an integrated general ledger, something that the current system does not have, and also moving from a cash basis of accounting to an accrual basis to support accounting for tax revenues (31.46).

The feeder systems that support the revenue reporting practices are of varying quality: some are quite labour intensive, while others are quite automated. The Audit revealed that input controls that ensure the accuracy or completeness of data, the timeframes required to clear unprocessed inventory or to follow up outstanding items are either inconsistent, incomplete or completely lacking. Customs and Excise is one area of particular concern, since its feeder systems are still largely manual, which makes its feeder systems archaic, slow and labour intensive. Already, the Department has taken certain steps to modernise its data capture systems. In its response to the Auditor General's Report (31.36), the Department formed a team in 1995 whose task was to look into the entire payment process systems at Revenue Canada, and to re-engineer it using the latest technology. The Committee learned that the Department is in the process of replacing the current manual payment processing systems with automated systems using the latest scanning and imaging technology. Phase I of the new Payment Processing Systems (PPS) is

scheduled for implementation in 1998. The Committee acknowledges the Department current efforts in updating its systems and therefore recommends:

That the Revenue Canada complete its updating of all its data capture and other information systems by the time it completes its re-engineering process by year 2002 and that it report its progress to Parliament.

The Auditor General Report stated (31.48 to 31.53) that the Department should perform accounting reconciliations on a more regular and timely basis in order to minimise errors to financial reporting and to derive assurance that systems and controls are performing as they should. Currently, the Department does not reconcile all revenues, offsetting payments and adjustments to amounts in central accounts on regular and timely basis, and it attempts a full reconciliation only once during the year end. Lack of full and timely reconciliation means that Revenue Canada cannot provide complete assurance on the accuracy and completeness of the amounts by revenue stream for monthly and year end external report. In his Opening Statement to the Committee, Mr. Wright, indicated the Department's re-engineering efforts to move towards a new Standardised Accounting System which will align all departmental accounting practices.

In addition, the Auditor General stated that the Department should reconcile its central account balance to its taxpayer records (31.52). Such a reconciliation would capture all adjustments, transfers or cash transactions and provide the ultimate check that cash and revenue reporting are complete and appropriately represented by revenue streams. The Committee shares the same concerns expressed by the Auditor General and thus recommends the following:

That Revenue Canada execute all the required reconciliations to assure sound financial management; and

That Revenue Canada upgrade its systems to provide more automated tools to support revenue reporting and assure on a regular basis full reconciliation of revenues streams, and develop and apply performance standards for its feeder systems.

The Department of Finance requires that Revenue Canada provide it with more analysis and more timely analysis to ensure the quality and reasonableness of month-end and year end numbers provided for external reporting and to explain period-to-period fluctuations (31.54). Revenue Canada informed the Auditor General that the responsibility of analysis of the reasonableness of revenue reports is shared between Finance, Revenue Canada Departmental Headquarters and its program branches, with the program branches bearing most of the responsibility since many revenue details are found in the feeder systems. The Auditor General noted that there are no standards in place relating to the type and frequency of the routine analyses to be performed, or the kind of data required to analyse period to period fluctuations (31.55). Also, program branches are not provided with any instructions as to what constitutes a significant fluctuation requiring prompt investigation (31.56). So instead of initiating analyses, the program branches tend to respond to queries emanating from Headquarters or Finance. The Auditor General believes that the Department should routinely analyse key volumetric data which would provide better understanding of reasonableness of revenue fluctuations.

The Auditor General also observed that the Department does not provide program branches any criteria on the required degree of accuracy for the revenue stream being reported in such publications as the Fiscal Monitor and for Public Accounts (31.56). While terms of reference for revenue reporting matters exist between Finance and Revenue Canada, they are expressed in broad terms, without any specific guidance as to what constitutes a significant distortion in each revenue stream, nor does Finance communicate to Revenue Canada about the

assumptions implicit in its revenue forecasts. This data could help Revenue Canada deal with interim or year-end reporting issues. It could also provide a better context to evaluate period-to-period revenue reports in terms of reasonableness and potential distortions.

In order to deal with reporting issues, the interdepartmental Fiscal Monitor Committee with representatives from Finance and Revenue Canada was set up two years ago (31.59). According to both departments, the Committee is a good forum for dealing with reporting issues and understanding respective needs and constraints. It is through this forum that questions on revenue fluctuations are raised by Finance for Revenue Canada's analysis and follow-up. Finance would like Revenue Canada to do more independent analyses and more timely analyses. In response, the Deputy Minister, Mr. Robert Wright, informed the Committee about a new revenue analysis unit that is scheduled to be fully staffed and operational by fall 1998 and that the Department is currently upgrading its program for the reconciliation of deposits to improve the accuracy of reporting revenues. The Committee also agrees that better coordination between departments is required in terms of timely analyses for identifying the causes underlying revenue fluctuations and thus recommends the following:

That Revenue Canada clarify expectations of program branches for analyses related to monthly revenue reports and that it should also provide them with threshold criteria regarding what constitutes significant revenue fluctuations to prompt investigative action; and

That Finance explicitly define the required levels of precision by type of revenue stream and provide Revenue Canada with economic assumptions underlying its revenue forecasts.

According to the Auditor General, recent government restraint initiatives have resulted in significant multiyear cuts in Revenue Canada's annual resources levels for regular workloads (31.76). The Department copes with declining revenue levels by concentrating funding reductions in administrative and program support areas. Other measures include offsetting funding reductions by savings generated from expected economies resulting from administrative consolidations and from a wide variety of business process engineering initiatives; and, finally, requesting additional resources from Treasury Board for any new work (e.g. new government priorities, tax policy initiatives, volume growth). Most funding issues are dealt with internally, and where absolutely necessary, referred to the Treasury Board.

The Auditor General noted that when making referrals for additional funding, Revenue Canada uses business cases to support its requests to the Treasury Board (31.83). Business cases are essential to the Department's process of obtaining funding for new work. The Auditor General found the business cases he examined to be qualitatively sound. But when it came to quantitative challenges, calculation errors or absence of satisfactory documentation were noted (31.88). A 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.

It was also noted that when the Department prepares its quantitative challenges, it does not apply consistently the effects of re-engineering and other business initiatives when estimating the costs for its requests for additional funding (31.89). Therefore the Committee recommends:

That Revenue Canada subject its business cases to more rigorous quantitative objective scrutiny.

The Auditor General's Report noted serious deficiencies in the Department's own budget and costing systems (31.91-93). Recognising the importance of costing and budgeting systems for an organisation of the size and scope as Revenue Canada, the Committee therefore recommends:

That when completing its specifications for its new systems, Revenue Canada should ensure capture of complete, timely, relevant program production and expenditure costs.

The Report found many weaknesses in Revenue Canada's formal systems. Many of the formal systems were noted to be old in design, labour intensive, inefficient, and slow to generate information. Often the data generated by these systems are fragmentary and, in many instances, do not provide the information required for management needs. In some cases, data extraction requests require long execution times, longer if extraction requests involve complicated data manipulations. To compensate for the formal system's many shortcomings; management has to rely on proxy measures, informal information systems and other bridging practices.

As the Auditor General stated, there are few assurances on the quality and reliability of the data generated out of these systems (31.99, 31.100, 31.101). The Committee therefore recommends:

That Revenue Canada ensure and periodically review the integrity of information in its systems.

In terms of its overall financial management environment, Revenue Canada assigns top priority to meeting the basic legal requirement and government initiatives often at the expense of other priorities, particularly in responding to internal administrative needs and sound financial management practices (31.107). The Auditor General noted that the Department has made satisfactory progress in correcting for deficiencies observed in previous reports, but shortcomings remain and are starting to have a cumulative effect on the Department's operations and its ability to fulfil its mandate (31.15). Revenue Canada must continue corrective actions and give appropriate priorities to correct remaining deficiencies.

Financial management at the Department cuts across every business line and is part of every program; it is essential to its operations. The responsibilities for financial management is shared and decentralised among Headquarters, program branches and regional operations. Shared responsibility requires a clear accountability and a minimum fiduciary expectation. Given the diversity of business lines and the various programs operating within them, functional guidance, standards, overall review and co-ordination of financial management systems and practices are required. However, it was found that the internal audit was not being used effectively to provide overall assurance on the state of corporate financial management (31.121). Mr. Robert Wright told the Committee that Revenue Canada recently formed an internal audit committee to review all of the internal audit programs with the mandate of making the internal audit function more independent and effective. In response, the Committee therefore recommends:

That Revenue Canada continue to strengthen the role of internal audit to provide senior management with independent assurance on the state of financial management at the Department.

Several questions concerning the preparedness of Revenue Canada for the year 2000 / "Millennium Bug" were raised by the Committee. Revenue Canada's Deputy Minister, Mr. Robert Wright, informed the Committee that the Department was making good progress at modernising its systems to make them fully year 2000 compliant. The Deputy Minister said that most major programs were now year 2000 compliant and expected the Department to be fully ready by its target date of 1 January 1999, which leaves it a full year to test out systems and address any problems. Committee members expressed concerns on the Department's ability to deal with other non-compliant systems and the possible impact it might have on Revenue Canada's own systems. Mr. Wright indicated that all possible system interfaces are currently being examined in an effort to deal with this issue. Mr. Wright also proposed to present the Committee with the package Revenue Canada intends send to its client groups in order to assist them to become year 2000 compliant. Finally, The Committee queried the witness as to whether the proposed transition towards Revenue Collection Agency could cause delays in its implementation of new systems and

procedures. Revenue Canada assured that the proposed move to Agency status would not put undue strain on its ability to proceed with the required changes to its systems, procedures and practices. The Committee therefore recommends:

That the Department complete its upgrading of all its major programs and systems to be year 2000 compliant by the target date of 1 January 1999 and that testing, validating and correcting of programs and systems be completed so that all systems are fully operational by 1 January 2000.

Conclusion

While the audit continued to observe some remaining deficiencies, notably in the areas of systems, procedures, reconciliation and analysis, it also commends the Department's serious intent and efforts to bring about the necessary changes to improve its financial management regime. The Committee encourages the Department to maintain the current momentum in order to address all outstanding issues regarding financial management.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 22 and 31)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Tuesday, 16 June 1998

Indian and Northern Affairs Canada

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FOURTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapters 35 and 36 of the December 1997 Report of the Auditor General of Canada (*Follow-up of Recommendations in Previous Reports – Indian and Northern Affairs Canada – On Reserve Capital Facilities and Maintenance – 1995, Chapter 23; Other Audit Observations – Escalating costs of on-reserve water supply projects not adequately justified and Lack of compliance with funding arrangements*) and the Committee has agreed to report the following:

Introduction

The on-reserve capital facilities and maintenance activity is an element of the Indian and Inuit Affairs Program administered by Indian and Northern Affairs Canada (the Department). It provides funding and support for Indian and Inuit communities to acquire, operate, and maintain basic non-residential facilities across Canada. The applicable budget for this activity for 1997-98 was \$806 million.

In Chapter 23 of his November 1995 Report, the Auditor General presented the results of his audit of the Department's management of the on-reserve capital facilities and maintenance activity. At that time he noted that the Department was devolving responsibility for the delivery of this activity to First Nations communities. The Auditor General observed that the Department had not identified and controlled areas of high risk and recommended a series of corrective measures. In its response, the Department agreed with the audit observations and indicated a willingness to take appropriate action. The Department reiterated these commitments in somewhat more detail in a letter to the Standing Committee on Public Accounts sent during the summer of 1996.

As an integral part of the audit cycle, the Auditor General reviewed the actions taken by the Department two years after the publication of the results of the original audit and presented his findings in Chapters 35 and 36 of his December 1997 Report.

The Committee believes that it is important to review the results of follow-up examinations conducted by the Auditor General. In this instance, because of the importance of this activity to First Nations' communities and its cost, the Committee decided to study the results of the follow-up. Accordingly, on 10 March 1998, the Committee met with Mr. Denis Desautels, the Auditor General of Canada, and Mr. Grant Wilson, Principal of the Audit Operations Branch, from the Office of the Auditor General. Mr. Scott Serson, Deputy Minister, and Ms. Cynthia Williams, Assistant Deputy Minister of Socio-Economic Policy and Programming and Program Redesign Sector, appeared on behalf of Indian and Northern Development Canada.

Observations and Recommendations

Following his review of the actions taken in response to his 1995 audit, the Auditor General reported that the Department had mostly focussed on internal studies and reviews. Actual results were disappointing. In terms of capital facilities projects, the Auditor General found “no significant improvements from key findings in 1995.” (35.248) He indicated that improvements are still needed in areas such as project risk assessments, monitoring, evidence of project completion and evaluation of project results. With regard to maintenance, the Auditor General reported that many fundamental problems remained unresolved. For example, he cited a 1997 departmental assessment showing that some First Nations lacked the training and expertise needed to maintain capital assets. Incentives to maintain these assets were absent and certain funding arrangements lacked a requirement for maintenance plans. The Auditor General pointed out, as well, that although responsibility for maintenance is being devolved to First Nations, not all of them have the capacity to identify their maintenance needs as required by the Department.

In June 1997, the Department issued draft compliance guidelines for the operation and maintenance of capital assets on reserves. The guidelines are meant to ensure that maintenance funds are spent for the purposes intended, that the conditions of facilities are assessed on an annual basis and action taken when needed, and that advice and assistance on maintenance are provided to First Nations. The Department expects that the guidelines will have been fully implemented for fiscal year 1998-99.

In his response to the Auditor General’s observations, Deputy Minister Scott Serson told the Committee that “significant progress has been made on each of the Auditor General’s five recommendations,” and that “several initiatives are ongoing and [the Department] expect [s] full implementation within the next few weeks.” In further testimony, he agreed to provide the Committee with a list of the Department’s initiatives and the target dates for their implementation.

The Committee recognizes that the Department faces certain challenges in effecting change in this area. The Committee believes strongly, however, that a more concerted effort by the Department would have significantly minimized the problems revealed by the follow-up review. The Committee therefore welcomes the Department’s commitment to fully implement — if belatedly — all of the Auditor General’s recommendations within the very near future. In early June, Mr. Serson informed the Committee by letter that the Department has now put measures in place to address the Auditor General’s 1995 recommendations. However, in light of the Department’s record, the Committee, will require concrete assurances that these commitments have been achieved and are producing the intended results. Accordingly, the Committee recommends:

That Indian and Northern Affairs make every effort to attain the targets it has established for implementing the recommendations contained in Chapter 23 of the 1995 Report of the Auditor General of Canada;

That Indian and Northern Affairs Canada monitor implementation of the recommendations contained in Chapter 23 of the 1995 Report of the Auditor General of Canada and report the results to the Committee by 30 September 1998; and

That Indian and Northern Affairs Canada regularly include references to its management of the on-reserve capital facilities and maintenance activity in its annual *Performance Reports* to the House of Commons. These references must focus on the results achieved as a consequence of expenditures on this activity.

The follow-up uncovered two cases that the Auditor General told the Committee were “typical of some of the difficulties that relate to on-reserve infrastructure development.” Rather than being isolated instances, Mr. Wilson confirmed similar cases could be found in other situations.

In the first case, the Department had given preliminary approval for a \$1 million for a new water supply development project. Estimated costs rose to \$2.3 million by April 1997.

The Department was aware, however, that the existing water supply system could have been repaired at an estimated cost of \$26,000. This would have avoided the need for a capital infrastructure project. The Auditor General asserted, however, that this option was not given due consideration. Furthermore, the Auditor General found that although the Department had given \$30,000 to the community in question to implement the lower-cost solution, “no evidence was available in the Department to show what improvements had been made with these funds.”(36.37). In his testimony before the Committee, the Deputy Minister was unwilling to claim that good value was achieved for the funds provided by the Department. This case demonstrates that the Department needs to do a better job of ensuring good value, monitoring projects and evaluating the results.

In the second case, the Auditor General found that the Department had approved an \$8.9 million project to be constructed by a First Nation without public tendering — in clear contravention of the funding arrangement between the Department and the First Nation that required public tendering for all construction contracts. The Auditor General told the Committee that “additional costs of up to \$1 million may have been incurred with questionable benefits.”

Mr. Serson told the Committee that the Department has implemented a policy requiring First Nations to publicly tender all federally funded construction contracts worth more than \$500,000. Instead, however, of providing the Committee with the reassurance it was seeking that such cases will not occur again in the future, this statement gives rise to additional concerns. The Committee notes the following:

- The Department had a funding arrangement that required a public tender but did not enforce it. Instead, the Department permitted an \$8.9 million contract to be awarded without competition.
- The decision not to enforce the public tendering requirement was taken at the regional level and was not reviewed by the Department’s senior management.
- The Deputy Minister stated, during testimony, that the Department tries “to encourage some creativity and flexibility” on the part of its regional offices with regard to the enforcement of tendering policies.
- The Auditor General reports that not all First Nations agree that bid tendering should be used to select construction contractors. (35.249)

Collectively, these factors strongly suggest that the Department may experience difficulty in obtaining compliance with its tendering policies.

An additional concern involves the \$500,000 threshold established by the Department to trigger a public tendering process. As the Auditor General indicated several times, this threshold is very high and is above that established for federal government agencies and departments when they issue contracts for construction and maintenance. The Committee shares this concern; assertions by Ms. Williams to the effect that the Department does not discourage First Nations from going to tender on projects valued at less than \$500,000 provide little comfort.

The Committee is of the firm belief that contracts for capital facilities projects and maintenance should be issued on the basis of rules that are clearly defined and communicated. The occasions on which such rules are modified should be extremely rare and subject to strict guidelines and review by senior departmental management.

The rules that apply to federal government departments and agencies — including Indian and Northern Affairs Canada — when they issue construction contracts are set forth in the Treasury Board Secretariat's Contracting Policy. These rules and the principles upon which they are based make an interesting contrast with the Department's policy on federally funded construction.

The Contracting Policy's objective is 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." The Policy states that government contracting shall be conducted in a manner that will "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," and "support long-term industrial and regional development and other appropriate national objectives, including aboriginal economic development."

Under these rules, all projects valued at or above \$25,000 must be subject to a public tendering process.

The Committee believes that the rules guiding First Nations' tendering policies with regard to federally funded capital facilities projects must be similar to those to which the Department itself has to follow when it contracts construction services. The Committee therefore recommends:

That Indian and Northern Affairs Canada immediately amend its policy with regard to federally funded on-reserve construction contracts to state that all contracts must follow the public tendering guidelines established by Treasury Board Secretariat's guidelines.

Although it would prefer strict adherence to this policy, the Committee recognizes that in certain circumstances, a degree of flexibility will be required. Deviation from this policy must, however, occur only within the context of clearly established criteria and must be subject to review. The Committee therefore recommends:

That Indian and Northern Affairs Canada establish criteria that are strict and clear to govern deviation from its policy on federally funded construction contracts;

That Indian and Northern Affairs Canada establish a requirement that any deviation from its policy on federally funded construction contracts must be subject to review and prior approval at the assistant deputy ministerial level; and

That Indian and Northern Affairs Canada report and explain deviations from its policy on federally funded construction contracts to the Parliament of Canada in its *Performance Report*.

The Committee has some additional concerns about the potential for contract or project splitting. Although the Auditor General told the Committee that his audit had not uncovered any instances of this practice (1655), the Committee believes that measures need to be put in place to manage this particular risk. The Committee is also concerned that non-competitive sole-source contracts might be monopolized by a small number of contractors. It therefore recommends:

That Indian and Northern Affairs Canada closely monitor the contracting process for all federally funded on-reserve construction projects, regardless of value, and that it work closely with First Nations communities to ensure access, competition, fairness, and transparency, and best value or, if appropriate, an optimal balance of overall benefits in terms of the results.

Conclusion

The Committee was disappointed with the results of the follow-up review. The actions taken by the Department in response to the original audit were insufficient and slow. The two cases that were revealed during the course of the follow-up are proof of this.

The Committee fully expects that the Department will now make every effort to correct problems identified by the Auditor General some time ago. Actions taken on those recommendations as well as the Committee's should ensure that on-reserve capital facilities and maintenance is properly managed and that those living in First Nations' communities receive the full benefit of this vitally important activity.

Pursuant to Standing Order 109, the Committee requests that the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 21 and 38)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 8 October 1998

Office of the Superintendent of Financial Institutions: Insurance and Pensions

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

FIFTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 30 of the December 1997 Report of the Auditor General of Canada (*Office of the Superintendent of Financial Institutions: Insurance and Pensions*) and the Committee has agreed to the following report:

Introduction

The financial industry is rapidly changing. The accelerated pace at which financial institutions are consolidating, technological advances and the ongoing development of interconnections between capital markets are resulting in a restructuring of the financial sector.

The Office of the Superintendent of Financial Institutions (OSFI) is a federal organization responsible for monitoring deposit-taking institutions, insurance companies and pension plans. On the whole, OSFI enjoys an excellent reputation among financial institutions and other regulatory agencies.

Since OSFI's inception in 1987, numerous changes have occurred in the financial industry and been made to the statutory provisions that govern it. OSFI has taken significant steps to adjust to those changes, in particular by placing greater emphasis on issues pertaining to solvency and good corporate governance to guarantee prudent management by the entities subject to OSFI supervision rather than to rely on compliance with statutes and regulations.

OSFI and other stakeholders, together with the financial industry, have developed sound codes of administrative and financial practice and guides to intervention for each of the sectors it regulates. OSFI continues to improve its regulatory framework by developing performance measures and new approaches to audit compliance with statutory and regulatory requirements.

An essential component of OSFI's success is its ability to adapt quickly to change. To meet these new challenges, OSFI must develop and maintain a strategic vision enabling it to revise its management strategy and framework to meet changing regulatory requirements over the long term. Although OSFI has managed to respond to the financial environment's present needs, it must nevertheless correct certain significant deficiencies in order to meet the needs of the future.

In view of the importance the federal government attaches to having efficient regulatory agencies, the Committee decided to consider Chapter 30 of the December 1997 Report of the Auditor General. On March 31, 1998, it met Mr. Denis Desautels (Auditor General of Canada), Mr. Ron Thompson (Assistant Auditor General) and Ms. Crystal Pace (Director, Audit Operations) from the Office of the Auditor General. The following individuals represented the Office of the Superintendent of Financial Institutions: Mr. John Palmer (Superintendent of Financial Institutions), Mr. John Thompson (Deputy Superintendent, Policy Sector) and Ms. Edna MacKenzie (Assistant Superintendent, Corporate Services Sector).

Observations and Recommendations

The Auditor General noted in his report that OSFI is experiencing certain difficulties in its human resource management and planning: many key positions are vacant, it is difficult to retain most valued staff and there is a high staff turnover rate (30.30). As a result of these problems, OSFI has for the past two years been completely reviewing its human resource management framework in light of the requirements of OSFI's mission and strategic objectives. The result of this process of reflection has enabled OSFI to isolate three major issues that must be resolved: How to recruit and attract staff, how to retain valued staff and staff training and development.

Many Committee members were concerned by the human resource issues, particularly the need to establish a formal human resource management system at OSFI and how to recruit and retain valued staff. As regards to the human resource management system, the Superintendent of Financial Institutions, Mr. John Palmer, indicated that OSFI subscribed to the Auditor General's recommendations on the need to formalize and document OSFI's human resources strategy. At the time of the audit, OSFI was developing a draft strategic planning document which is expected to be completed in late spring 1998. The purpose of the document is to respond to the need perceived by the Auditor General to introduce a formal human resource strategic planning framework to link OSFI's human resource management activities with its vision of future developments in the regulation of the financial industry.

The Committee was informed by Mr. John Palmer that most of the major initiatives were still under way. The most time-consuming initiative is the so-called "universal classification", which consists in integrating 15 separate pay groups and 14 occupational groups. When the exercise is completed, OSFI hopes that the universal classification will give it more flexibility to assign employees to positions that make the best use of their abilities and to eliminate salary differences between various pay levels, which, in OSFI's view, is one cause of staff dissatisfaction.

The Committee also learned that OSFI was having problems retaining valued staff. More than ever, many of its new recruits are leaving OSFI after one or two years in the organization for more highly paid positions in private sector financial institutions. This phenomenon has resulted in a high staff turnover rate and some positions have remained vacant for long periods of time. Committee members questioned the witnesses to determine the causes of this high staff turnover rate. According to the Superintendent of Financial Institutions, Mr. John Palmer, the main cause was that OSFI's pay structure was not comparable with that provided in the private sector and that OSFI did not have all the flexibility it needed to adjust its pay scales in view of the limits imposed by the *Public Service Employment Act*. OSFI stated however that it was not seeking complete parity with the private sector, but rather to adjust the mid-ranges of its pay structure to become more competitive with the market. Mr. Palmer mentioned that OSFI was developing a proposal for the government to request adjustments to its pay structure.

Committee members nevertheless expressed certain reservations over OSFI's main approach, which is to readjust its pay scales so as to better retain staff. Some suggested that, instead of adjusting the pay structure, it would also be prudent to promote the organization's employee benefits, working conditions, training and development opportunities and job permanence or security. Other members went so far as to suggest inserting non-compete

clauses in employment contracts or even adding conflict of interest guidelines to counter private sector raiding of OFSI staff. As a result, the Committee recommends:

That OSFI complete all initiatives concerning its human resources management system on time and that it regularly indicate in its annual performance report to Parliament the progress on these initiatives and indicate any developments that might slow down or undermine those initiatives; and

That OSFI conduct a thorough and well documented analysis to clearly determine the causes of its difficulties in retaining staff. Once the causes have been ascertained, that it thoroughly review all components of the staff compensation system, including the pay structure, employee benefits, training and development programs, as well consider the possibility of including non-compete clauses in employment contracts, so as to be in a better position to retain staff.

The Auditor General observed that OSFI is a recognized leader in the regulation of financial institutions. By introducing its standards for sound business and financial practices and guides to intervention, developed in cooperation with its financial sector partners, OSFI has developed from a regulatory framework based on the compliance of statutes and regulations to a risk assessment and management system (30.7 and 30.8). In his report, the Auditor General observes that the system should be applied more uniformly (30.60). In particular, he describes cases in which OSFI was reluctant to inform a company of a change in its risk rating (30.61 and 30.90) out of fear that public disclosure of the change would undermine the efficiency and effectiveness of its work (30.61).

The Superintendent of Financial Institutions, Mr. John Palmer, wished to inform the Committee that there was no question of OSFI disclosing rating changes to the public, that OSFI was required by law to keep confidential information obtained from financial institutions and that it was impossible for OSFI to publicly disclose its conclusions based on that information. What OSFI fears the most is that financial institutions, which are not legally required to keep their ratings confidential, could disclose them to the public in order to secure an unfair competitive advantage.

The witness for OSFI, Mr. John Palmer, indicated that the ratings disclosure process could be better documented and informed the Committee about recent OSFI initiatives to inform financial institutions of changes to their ratings in a more uniform way.

One of the main initiatives is a thorough reorganization of OSFI to restructure the operations and policy sectors and to review the main mechanisms for monitoring financial institutions and developing regulatory policy. At the same time as the reorganization of its operations sector, OSFI intends to introduce a new form of monitoring and a new risk rating system based on the main risks to which financial institutions are exposed and on the controls they have established to manage those risks. The key components of the new monitoring method will be a standard evaluation of compliance with sound business and financial practices and a coherent implementation of the guides to intervention. This rating system review process is expected to be completed in two years.

The Superintendent of Financial Institutions, Mr. Palmer, then informed the Committee that OSFI currently has set up certain transitional measures for disclosing the results of its examinations of the financial institutions, without giving out overly specific information that the financial institutions could then disclose to the public. OSFI will arrange to be in a position to communicate ratings to financial institutions as soon as the new monitoring method is completed, in two years. In the meantime, OSFI hopes of the passage of appropriate statutory measures compelling the financial institutions to keep their ratings confidential. The Committee acknowledges OSFI's efforts regarding monitoring and disclosure of rates and recommends:

That OSFI pursue and complete its reorganization of its financial risk monitoring and rating systems as soon as reasonably possible; and

That OSFI regularly indicate in its annual performance report to Parliament the progress being made on this reorganization and indicate any developments that might slow down or undermine it. If public disclosure of risk rating is a genuine problem, that OSFI seek to have the act or regulations amended to prevent such disclosure.

Committee members also raised the question of the lack of actuarial resources and felt there should be better co-ordination between the work of OSFI's examiners, analysts and actuaries. The Superintendent of Financial Institutions, Mr. John Palmer, accepted the Auditor General's observations and recommendations and, in his address to the Committee, outlined the measures OSFI intends to take to correct the situation. The main initiatives amount to a thorough reorganization of OSFI, part of which will focus on the operations sector and should appreciably improve co-ordination of the work of analysts, examiners and actuaries.

The reorganization is expected to do two things for the actuaries. Some actuaries will be incorporated in monitoring groups and will be responsible for directly overseeing and examining insurance companies. Second, OSFI is currently forming a team of consulting actuaries who will support the control teams, show them how to better understand important actuarial issues and focus on certain projects that OSFI is conducting jointly with the Canadian Institute of Actuaries (CIA) to consolidate its actuarial practice because OSFI relies on the work of the actuary designated by the company to conduct its own actuarial analysis. OSFI intends to finish the reorganization by the end of the next fiscal year and to complete the actuarial component within three years. The slow pace of the consolidation is attributable to the fact that the Canadian Institute of Actuaries is an organization of volunteers and it is very difficult to set a deadline. In view of the above, the Committee recommends:

That OSFI continue and complete its reorganization and its actuarial consolidation as soon as possible; and

That OSFI regularly indicate in its annual performance report to Parliament on the progress being made on the reorganization and indicate any developments that might slow down or undermine it.

Lastly, the Committee questioned the witnesses on the financial industry's readiness for the year 2000 problem. The Committee was informed that, in the course of its annual examinations over the past two years, OSFI has been looking at the work done by the financial institutions to prepare their computer systems. OSFI is closely monitoring progress by the financial institutions and reviewing their plans to audit year 2000 readiness. Since OSFI is not an expert in the field, all it can state with any certainty is that the financial institutions and companies appear to be taking the necessary steps to prepare themselves. OSFI recognizes the need to expand and strengthen its knowledge of information technologies and thus intends to set up an expert group consisting of eight advisory groups by the end of the year. With this organization, OSFI hopes to take a closer look at the issue and to identify more clearly potential problems that may arise in preparations for the year 2000.

OSFI reported on its own year 2000 preparations. It has introduced a conversion program to replace all its computer hardware, approximately 400 microcomputers, with new bug-free equipment. This conversion should be complete by the end of 1998. In view of the above, the Committee therefore recommends:

That OSFI continue its follow-up and examination of the financial industry institutions it regulates and that it notify Parliament as soon as possible of any developments that could compromise the

integrity of computer systems in the financial sector and compromise the assets of depositors, insurance policy-holders and pension plan members; and

That OSFI complete its own computer hardware conversion as soon as possible so as to be ready for the year 2000.

Conclusion

The Committee wishes to mention that the Office of the Superintendent of Financial Institutions has made significant progress in recent years to become a leader in the regulation of financial institutions and congratulates it on the initiatives it has taken to respond to the recent recommendations by the Auditor General of Canada.

The Committee has every hope that adoption of these recommendations and those of the Auditor General will help the Office of the Superintendent of Financial Institutions to continue its efforts to regulate the financial industry in the interest of the depositors, insurance policy-holders and pension plan members.

Pursuant to Standing Order 109, the Committee requests the Government table a comprehensive response to this Report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 25 and 40)* is tabled.

Respectfully submitted,

John Williams

Chair

REPORTS TO THE HOUSE

Thursday, 8 October 1998

Population Aging and Information for Parliament: Understanding the Choices

Pursuant to Standing Order 108(3)(e), the Standing Committee on Public Accounts has the honour to present its

SIXTEENTH REPORT

The Standing Committee on Public Accounts has considered Chapter 6 of the Report of the Auditor General of Canada from April 1998 (*Population Aging and Information for Parliament: Understanding the Choices*) and has agreed to present the following report:

Introduction

In the next century, once the earliest members of the baby boom have reached normal retirement age, the growth rate of Canada's elderly population will be increasingly rapid while that of the active population will slow down markedly.

This general aging of the Canadian population could have negative effects on public finance. An older average population means greater pressure on public spending, in the form of higher pension payouts and demand for health-care services. Failing a major transformation of our patterns of work, this demographic change will put a considerable brake on the growth of the labour force, which will mean slower economic growth and thus lower public revenues. By the second decade of the coming century, when the full impact of the demographic change will begin to be felt, this combination of factors could have serious consequences for Canada's public finances, especially if Canada's debt load and taxation rates remain high.

Already many countries are paying attention to the impact of demographics on their public finances. For example, the United States and Denmark publish fiscal balance projections 40 to 50 years ahead. The United States, Argentina, New Zealand and Norway produce "generational" accounts, to give a long-term orientation to the budget process. The United Kingdom recently announced the introduction of a new fiscal stability code that provides for the formulation of financial projections over at least ten years, in order to shed light on the generational effect of the government's budget strategy.

The financial framework of the Canadian government is based on a short-term outlook horizon.

The federal government does take into account the possible influence of demographics on its public finances. It considered this question when it launched the pre-budget consultation process in the fall of 1997, without however specifically defining the possible future financial impact. In addition, during consultations on reforming the Canada Pension Plan (CPP), the federal government disclosed detailed financial information about the constraints facing the CPP in the years to come, in light of foreseeable demographic trends. To a lesser extent, the

government has committed itself to a similar process for the reform of Old Age Security (OAS) and the Guaranteed Income Supplement (GIS). In the opinion of the Office of the Auditor General, the impact of demographic factors on the government's financial health should be determined for all aspects of government operations.

The purpose of analysing demographic trends when planning budgetary and fiscal projections is to obtain a clearer idea of the long-term consequences of each year's budget decisions.

It was in the context of these issues that the Standing Committee on Public Accounts decided to consider the findings and observations in Chapter 6 of the Auditor General's Report from April 1998, on population aging and information for Parliament. On June 9, 1998, the Committee met with Mr Denis Desautels (Auditor General of Canada), Mr Ron Thompson (Assistant Auditor General) and Mr Basil Zafiriou (Director, Audit Operations). The Department of Finance was represented by Mr Scott Clark (Deputy Minister), Mr Don Drummond (Assistant Deputy Minister) and Mr Peter DeVries (Director, Fiscal Policy, Economic and Fiscal Policy Branch).

Observations and Recommendations

In his introductory comments to the Committee, the Auditor General stressed the importance of communicating to parliamentarians and Canadians generally about the impact our aging population will have on economic activity in general and on public finances in particular. His aim was to explain the importance of giving Canadians a better understanding of the possible effects of demographic trends on the long-term situation of the country's public finances, and to demonstrate the links that exist between demographic trends and the current process of short-term budget decision-making.

According to the Auditor General, the value of demographic projections is not found in the numbers themselves (which are fraught with uncertainty) but rather that they compel people to think about the future impacts of short-term budget decisions. The goal is to introduce greater transparency in the budget process, however without making the government accountable for the accuracy of long-term demographic projections.

In his statement to the Committee, the Deputy Minister for the Department of Finance said that he is in full agreement with the conclusions found in the Auditor General's report; after all, good information is the foundation of good fiscal policy. Any disagreement centres on process. The Deputy Minister of the Department, Mr Scott Clark, expressed concern that the introduction of long-term forecasts would create unrealistic expectations about the government's ability to respect its own demographic projections and would distract it from the important objective of coping with short-term budgetary issues. The witness reminded the Committee that achieving long-term budget goals depends on the ability to achieve short-term budget objectives.

The federal government hesitates to publish long-term projections partly because of a desire to concentrate its attention on immediate problems, but partly because it fears being held accountable for achieving long-term projections, which certain people would consider as long range targets. Mr Clark used as an example the appearance of the Minister of Finance before the Main Estimates Committee to discuss the Department's budget. In his comments, the Minister alluded to the fact that the debt-to-GDP ratio in the United States was about 40 per cent and said it would be nice if Canada could have a comparable ratio. The next day, according to the witness, one of Canada's financial newspapers announced that the Minister of Finance was about to set a new debt target.

According to Mr Clark, the government's approach at the present time consists in establishing two-year mobile fiscal targets, which are then embedded in a medium-term fiscal framework. The first medium-term strategy anchor was the elimination of the budget deficit. Implicit in this objective was the need to halt the rise in the public

debt and to put public finances on a sounder footing, so that the debt/GDP ratio could be kept on a permanent downward track. The Department is not planning to change this approach, which it considers as an effective formula in light of recent improvements in the health of Canada's public finances. The time may come, however, when longer-term fiscal projections again become part of the broader discussion of fiscal policy issues.

The Committee questioned the witness about the conditions that would lead the government to consider re-introducing long-term projections. Without describing any specific conditions, the Deputy Minister of Finance, Mr Clark, said he would like the government to build up more successes in meeting its short-term fiscal targets and to make public finances even healthier before thinking of introducing longer-term financial analysis.

The Committee, after hearing the comments and observations of the Auditor General and the representatives of the Department of Finance, proposes the following recommendations:

That the Department of Finance formulate a mechanism that the government could use to disseminate long-term demographic and fiscal information that would ensure transparency and greater understanding of the issue; and

That the Department of Finance report periodically to the Committee on the progress being made in this regard.

Conclusion

The Standing Committee on Public Accounts recognises that the Department of Finance has achieved success in placing Canada's public finances on a sounder footing. However, the Committee is of the opinion that it is becoming important to study demographic trends when planning fiscal and budgetary policy. Given that there is scarcely a decade remaining before the first waves of the baby boom arrive at retirement age, it is important that the federal government ensure that it will be able to continue to deliver essential public services to Canadians .

Measures taken in response to the Auditor General's recommendations and those of the Committee should be adequate to meet the concerns raised by the Auditor General's Report.

Pursuant to Standing Order 109, the Committee requests that the government table a comprehensive response to this report.

A copy of the relevant *Minutes of Proceedings (Meetings Nos. 37 and 40)* is tabled.

Respectfully submitted,

John Williams

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 (not tabled for 1998 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 1998. 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 Tabling 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 73 instances of documents that were tabled late, relating to 16 of 40 Crown corporations required under the *Financial Administration Act* to table reports in the year. This represents approximately 20 percent of those documents that were required to be tabled and is similar to previous years.

Further, the report on tablings does not disclose that the following documents have not, as contemplated by subsection 122(1) of the *Financial Administration Act*, been approved by the Governor in Council:

- Atomic Energy of Canada Limited's corporate plans for 1995-96 to 1999-2000, 1996-97 to 2000-01, and 1997-98 to 2001-02; and
- Canada Post's corporate plan for 1997-98 to 2001-02 and its capital budget for 1997-98.

As a result, the related summaries of these documents have not been tabled in either House of Parliament.

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