

REPORT

OF THE

COMMISSION

TO INQUIRE INTO THE

MARTINEAU DEFALCATION, &c., &c.

PRINTED BY ORDER OF PARLIAMENT



OTTAWA

PRINTED BY S. E. DAWSON, PRINTER TO THE KING'S MOST
EXCELLENT MAJESTY

REPORT
OF THE
COMMISSION TO INQUIRE INTO THE MARTINEAU DEFALCATION, &c., &c.
COMMISSION
CANADA.



MINTO.

[L.S.]

E. L. NEWCOMBE,
Deputy Minister of Justice,
Canada.

EDWARD THE SEVENTH, by the Grace of God, of the United Kingdom of Great Britain and Ireland, and of the British Dominions beyond the Seas, KING, Defender of the Faith, Emperor of India.

To all whom these presents shall come, or whom the same may in any wise concern.—GREETING.

WHEREAS it appears from a Report from Our Privy Council for Canada, stating that they have had under consideration an Extract from the Minutes of Our Treasury Board of the Fifth day of March, in the Year of Our Lord one thousand nine hundred and three, respecting the recent defalcations in the Department of Militia and Defence, and the methods of keeping the accounts therein, and recommending the appointment of certain Commissioners to inquire into all the circumstances connected with the said defalcations, and into the methods of keeping the accounts in the several departments of our Government of Canada, particularly in relation to the issuing of cheques and the receipt and disposal of public moneys, and to report what changes, if any, are deemed advisable for the purpose of securing the fullest possible protection of the public interest;

AND WHEREAS, We deem it expedient that inquiry should be made with respect to the said matters hereinbefore mentioned;

Now KNOW YE that WE, by and with the advice of Our Privy Council for Canada, do by these presents nominate, constitute and appoint JOHN MORTIMER COURTNEY,

Esquire, Companion of Our Most Distinguished Order of Saint Michael and Saint George, Deputy Minister of Finance, GEORGE BURN, Esquire, of the City of Ottawa, General Manager of the Bank of Ottawa, and AMBROSE L. KENT, of the City of Montreal, Chartered Accounts, to be Our Commissioners to inquire into and report upon the matters and things hereinbefore mentioned.

AND WE do hereby, under the authority of the Revised Statutes of Canada, Chapter 114, intituled: 'An Act respecting Inquiries concerning Public Matters,' confer upon you, Our said Commissioners, the power of summoning before you any witnesses and of requiring them to give evidence on oath, orally or in writing, or on solemn affirmation, if they are persons entitled to affirm in civil matters, and to produce such documents and things as you, Our said Commissioners, shall deem requisite to the full investigation of the matters into which you are hereby appointed to examine, inquire into and investigate. To have, hold, exercise and enjoy the said office, place and trust unto you the said John Mortimer Courtney, you the said George Burn, and you the said Ambrose L. Kent, together with all the rights, powers, privileges and emoluments unto the said office, place and trust of right and by law appertaining during pleasure.

AND WE do hereby require and direct you to report Our Secretary of State of Canada, the result of your investigation, together with the evidence taken before you, and any opinion you may see fit to express thereon.

IN TESTIMONY whereof We have caused these Our Letters to be made Patent, and the Great Seal of Canada to be hereunto affixed.

WITNESS :—Our Right Trusty and Right Well-beloved Cousin and Councillor, the Right Honourable Sir Gilbert John Elliot, Earl of Minto and Viscount Melgund of Melgund, County of Forfar, in the Peerage of the United Kingdom; Baron Minto of Minto, County of Roxburgh, in the Peerage of Great Britain, Baronet of Nova Scotia; Knight Grand Cross of our Most Distinguished Order of Saint Michael and Saint George, &c., &c., Governor General of Canada.

At Our Government House, in Our City of OTTAWA, this SIXTH day of MARCH, in the year of Our Lord, one thousand nine hundred and three, and in the Third year of Our Reign.

By Command,

(Signed) P. PELLETIER,

Acting Under Secretary of State.

REPORT

To His Excellency the Governor General in Council.

MAY IT PLEASE YOUR EXCELLENCY :—

The Commissioners appointed by Commission of the 6th March, 1903, have, in accordance with the directions therein contained, the honour to present the following report :—

The Commissioners in making their report propose to divide it into three parts, following the terms of the Commission :

1st. An inquiry into the circumstances connected with the Martineau defalcation.
2nd. An inquiry into the method of keeping the accounts in the several departments of the government, particularly in relation to the issuing of cheques, and the receipt and disposal of public moneys.

3rd. Suggestions which they have the honour to make, and which they deem advisable for the purpose of securing the fullest possible protection of the public interest.

With reference to the first part of their instructions respecting the Martineau defalcation, the Commissioners find that Martineau started upon his duties in the Department of Militia and Defence on the 1st August, 1901, at the age of 26 years, and was given employment in the Accountant's branch of the department.

In October, 1901, the department being short handed, and the officer being absent whose duty it was to draw the cheques against the departmental Letter of Credit on the Bank of Montreal, Martineau was called upon temporarily to replace this employee, and was given charge of drawing the cheques.

It appears on examination that the cheques drawn by the Department of Militia and Defence had not printed numbers, but were numbered with the pen; and that it was the practice of the department when a cheque had been erroneously drawn to destroy it and have it replaced by a cheque taken from the back of the cheque book.

In this month of October certain cheques, seventeen in all, had to be sent to the superintendent of stores at Toronto. Fifteen of such cheques were for payments for extra work performed by labourers there on the occasion of the visit of Their Royal Highnesses the Prince and Princess of Wales, and the remaining two were for regular accounts for services performed at Toronto.

It further appears that it was not the habit of the Department of Militia and Defence in sending out cheques to inclose accompanying letters. On the receipt of the envelope at Toronto only two cheques were found inclosed therein. The fifteen cheques have never turned up from that day to this, and the labourers have not yet been paid.

The Commissioners found on looking at the cheque book that fifteen cheques at the end of the book had been torn out, probably by Martineau for the purpose of carrying out his defalcation.

It cannot be ascertained, as the cheques are non-existent, whether the fifteen cheques taken from the back of the book were used, or through erasure the amounts raised and names of other persons inserted in the missing Toronto cheques. But after conviction Martineau stated that the moneys were obtained by him from the bank on forged cheques, which cheques on being returned to the department were with the statement from the bank destroyed by him.

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The Commissioners are inclined to the opinion that the signatures on all the cheques circulated by Martineau were forged by him.

Martineau, in addition to drawing cheques temporarily when the employee whose duty it was to do so was absent or otherwise engaged, was also entrusted at the end of each month with the work of adjusting the bank account. It appears that his practice was, when the bank sent in the statement with the accompanying cheques, to abstract the illegitimate cheques and to hand over the statement after he checked it to another officer of the department. This officer, who has for many years been in the service of the department, signed the monthly receipt sent by the bank to the department at the end of the month with the statement showing the bank balance, on the word of Martineau that the bank account had been verified by him and found correct.

It appears that the department for many years neglected making a list of outstanding cheques at the end of each month; that they only made a list of outstanding cheques once a year; and that this list was not prepared until about six months after the end of the fiscal year.

In January, 1903, suspicion was aroused as to the correctness of the bank balance. On an examination being made by the department, it was found that the statements furnished by the bank from December, 1901, to December, 1902, were missing, and copies had to be procured. It was then discovered that the following amounts had been charged by the bank for which no cheques had been drawn by the department:—

Fiscal Year 1901-02.

| Cheque No. | Amount. |
|------------|-------------------|
| 6370 | \$ 363.53 |
| 6428 | 2,965.92 |
| 6454 | 2,851.51 |
| 7362 | 3,819.04 |
| 9141 | 4,355.00 |
| 9601 | 5,650.00 |
| | <hr/> \$20,005.00 |

Fiscal Year 1902-03.

| Cheque No. | Amount. |
|------------|-------------------|
| 166 | \$ 6,700.00 |
| 184 | 7,500.00 |
| 205 | 8,300.00 |
| 207 | 7,700.00 |
| 2999 | 12,000.00 |
| 3050 | 13,500.00 |
| | <hr/> 55,700.00 |
| | <hr/> \$75,705.00 |

The defalcation commenced by Martineau issuing cheques for sums similar in date, number and amount to genuine cheques previously drawn. He evidently considered that if notice was taken of these amounts the department would be satisfied by an explanation that the bank had entered cheques twice over. Finding, however, that no notice followed, Martineau became bolder and bolder, until large sums were abstracted without disguise from the treasury.

The accountant of the department, finding that illegitimate cheques had entered into the bank account, made inquiries at the bank, and was informed in what manner the cheques were cleared. He also learned that Martineau had opened three accounts,

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one in his own name in one of the banks in Ottawa, and two, in the fictitious name of Chas. D. Coté, in two other banks in Ottawa. Martineau stated in each case that he was a paymaster of the department.

On this discovery being made, Martineau was immediately arrested. On his person at the time of his arrest was found the sum of \$12,443.77, which was at once secured. A few small sums in addition have also been obtained, but the greater part of the money he fraudulently acquired seems, on inquiry, to have been lost in stock speculations.

The Commissioners find that the Bank of Montreal has been in the habit of sending to the several departments the paid cheques as they accumulate, together with a statement of the amounts. The bank fills in the sheets and forwards them from time to time to the department concerned. At the end of the month the closing sheet for the month is made up, showing the balance of the account at the bank. This is sent forward with the remaining paid cheques.

It would appear that the first suspicion of any discrepancy was aroused by the assistant of the accountant of the Militia Department noticing that the balance as stated by the bank showed a less amount than the balance of the Letter of Credit account as shown in the books of the department.

The system of issuing letters of credit and of repaying the bank on account thereof, is governed by section 30, chapter 29 of the Revised Statutes of Canada, which lays down what shall be done in the matter as follows :—

1. The Minister of Finance and Receiver General may, on the application of the Auditor General, cause credits to be issued in favour of the deputy heads, officers, clerks or other persons connected with the several departments, or services charged with expenditure of the moneys so authorized.

2. That statements in duplicate of moneys drawn for under such credits, together with the cheques paid by the bank in connection therewith, shall be rendered at such times and under such forms as and once in each month or more often as the Treasury Board directs.

3. A duplicate of the statement, together with the cheques to be rendered to the Auditor General; and he, being satisfied with the correctness of the statement, shall cause cheques to be prepared to reimburse the banks for such advances under such credits to cover the expenditures; such cheques to be signed by the Minister of Finance and Receiver General, and counter-signed by the Auditor General.

The Commissioners find that the Audit Office did not, until after the time of Martineau's defalcation, require from the departments the bank statements. But the practice of the Bank of Montreal has been to send to the Auditor General at the middle and end of each month an abstract of the balances standing, not only to the credit of the Receiver General's account, but also to the credit of each Letter of Credit account.

These abstracts do not seem to have been taken into account by the Audit Office, and on investigation the Commissioners find that, for at least six months, the balance rendered in the abstract by the Bank of Montreal, as standing to the credit of the Department of Militia and Defence, in their Letter of Credit account, were less than the balances shown by the books of the said department, as will be seen by the subjoined figures.

| Date. | Balances rendered monthly to Audit Office by Bank of Montreal. | Balances rendered monthly to Audit Office by Dept. of Militia and Defence. |
|--------------|----------------------------------------------------------------|----------------------------------------------------------------------------|
| 1902. | | |
| September 30 | \$ cts. 76,565 45 | \$ cts. 96,474 52 |
| October 31 | 62,373 08 | 75,785 73 |
| November 30 | 90,241 04 | 113,138 36 |
| December 31 | 142,694 02 | 182,537 64 |
| 1903. | | |
| January 31 | 30,427 24 | 61,010 73 |
| February 28 | 118,745 68 | 158,711 22 |

Naturally the bank balances should have been greater than the Departmental balances, on account of cheques drawn and outstanding, which had not been presented and paid by the bank. These would amount to some thousands of dollars each month, as a large number of the cheques issued under the Departmental Letter of Credit accounts are generally drawn towards the end of the month, and are largely outstanding when the statements of the bank transactions, which are completed at the end of the month, are forwarded to the departments.

The Auditor General disclaims responsibility for the discovery of forgeries. But the Commissioners are of opinion that had the Audit Office compared the statement of the bank account, as furnished them by the department, with the balances rendered to the Auditor General by the Bank of Montreal, the defalcation would have been earlier discovered. It appears that the practice of the Audit Office, as regards the bank account, was to take it into consideration only when the Letter of Credit accounts were finally closed at the end of the fiscal year and an adjustment made.

Martineau must have been aware of this manner of dealing with the bank account, for although a certain portion of the defalcation amounting to about \$20,000.00 occurred in the fiscal year 1901-02, the bank account was adjusted by means of a letter sent to the Bank of Montreal requesting the transfer of \$20,000.00 to be made from the letter of credit account of 1901-02 to that of 1902-03. This letter authorizing such transfer is held by the Bank of Montreal, and on examination of it the Commissioners found that the signature of the accountant of the department, purporting to authorize this transfer, was forged.

The Commissioners have now to take up the second part of their instructions, viz.:—To inquire into the methods of keeping the accounts in the several departments of the government, particularly in relation to the issuing of cheques and the receipt and disposal of public moneys.

The Commissioners have to report that they have examined all the departments, and have inspected the methods employed in each for the keeping of accounts and for the collection and disbursement of public moneys.

The three Commissioners visited each department. The examination into the form of book-keeping was taken up by Commissioners Messrs. Geo. Burn and A. L. Kent.

The Commissioners are glad to report that the system employed, although lacking in uniformity, which is no doubt owing to the diversity of the several services, is sufficient for all requirements, and that the accountants in most of the departments are

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men of more than ordinary ability, who are keenly alive to the necessity of adopting all the modern improvements which the ever increasing growth of the public business necessitates.

The Commissioners are further pleased to note that, notwithstanding the overcrowding in many of the departments, the employees for the most part seem to perform their duties promptly and satisfactorily. The immunity which the government has enjoyed for many years past from any serious loss is doubtless due largely to their zeal in the public service.

The Commissioners, in the course of their inspection, suggested to all the accountants the desirability of meeting together at stated periods for promotion of uniformity in the conduct of their portion of the public accounts. They are glad to find that this suggestion has been adopted, and an association organized.

The Commissioners have now to make the following observations on the several departments :—

They find it is a universal rule that no cheques are signed in blank.

AUDITOR GENERAL'S OFFICE.

The Commissioners find that the auditing work of the Auditor General's office is admittedly always behind, and at certain periods of the year, during the preparation of the annual report, it falls very much in arrear.

The Commissioners find that a large portion of the staff of the Auditor General's office is employed during the first half of each fiscal year in compiling the material for his report, and during this time certain portions of the ordinary work are neglected.

The Commissioners believe that while the methods employed by the Auditor General's staff for the detection of errors and irregularities may have been effective heretofore they cannot be thoroughly satisfactory for the reason before stated. They are of opinion that an addition should be made to the staff in order that the preparation of the report may not interrupt those employees whose business it is to keep the audit up to date.

MILITIA DEPARTMENT.

The Commissioners find that receipts to the bank for cheques returned were given without counting the cheques for verification, and that the statement of outstanding cheques was sent to the Auditor General yearly instead of monthly.

It is further found in this department that there is a danger in issuing to paymasters cheques for large amounts for the payments of large bodies of men in camp. If it is impossible for this system to be altered, and if it is necessary to give large sums of money to paymasters for this purpose, the Commissioners think it would be desirable to associate another person with the paymaster and make them both responsible.

MOUNTED POLICE.

The Commissioners find that the paid cheques are sent to the Auditor General every six months instead of monthly.

PUBLIC WORKS DEPARTMENT.

The Commissioners find that the personal ledger is in arrear, and that in consequence duplicate payments have been made.

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AGRICULTURE DEPARTMENT.

The Commissioners find that the bank-book is balanced yearly and cheques transmitted to the Auditor General every six months instead of monthly.

MARINE AND FISHERIES.

The Commissioners find that no personal ledger is kept in the department. They deem it desirable that such a book should be opened.

PRINTING BUREAU.

The Commissioners find that no personal ledger is kept in this department, and in consequence a duplicate payment was made, but was discovered by the Bureau, and a deduction to the extent of such overpayment made from the next account. It does not appear that the Auditor General called the attention of the Bureau to the overpayment in question.

INTERIOR DEPARTMENT.

The Commissioners consider that a vault is urgently required for the Interior Department for the preservation of the survey maps, records, blank land scrip, cheques, &c. During their visit it was discovered that the clerk in charge of the cash was in possession of considerable sums in cheques, cash, money orders, &c., held by him pending instructions for the disposal of same, and that there was no proper receptacle for their safe-keeping. Since the visit of the Commissioners steps have been taken by which this holding of the cash has been discontinued.

The Commissioners find in all the Departments more or less overcrowding. This is particularly the case in the Currency branch of the Finance Department, where on account of the sorting and handling of old and worn notes, the conditions are a menace to the health of the employees.

Although not strictly within the terms of the Commission the Commissioners cannot refrain from bringing to the notice of the Government the danger from fire to the records in the upper part of the Eastern Block, owing to the proximity of the steam pipes to the woodwork in the corridor leading to the Indian Department. They think this calls for immediate attention. The charred condition of the floor touching the pipes shows that a conflagration is imminent, and measures should be taken to avert it. The lack of provision against fire also applies to the attic of the Langevin Block, where the records of the surveys under the control of the Department of the Interior are stored. These records are exceedingly valuable, as they represent the results of very large outlays of public money and cannot be duplicated.

The Commissioners have now to take up the third part, viz.:—To report what changes, if any, are deemed advisable for the purpose of securing the fullest protection of the public interest.

The Commissioners, before entering on this part of their report, beg to point out that the Martineau defalcation occurred under the letter of credit system. This system they desire to state has been in operation in Canada for over 30 years, and has been found to be an unqualified success. It has placed within the reach of every department of the service a simple and easy means of making such payments as could be made before audit in the speediest manner possible. At the same time it has enabled the Finance Department to utilize the government funds to the best possible advantage. The system also affords ample security against fraud if properly administered. The Commissioners further desire to state that since the inception of the letter of credit system the only defalcation under it that has occurred is this one in the Militia

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Department, and this through no defect of the system but in consequence of its faulty administration.

The system, in the opinion of the Commissioners, is admirable. But in order to prevent a recurrence of a defalcation, or of any tampering with the government funds or accounts, and to bring the whole banking system more under the control of the Finance Department where it properly belongs, and at the same time to leave to the several departments the facilities for speedy payment of accounts, the Commissioners suggest that the following method might be adopted:—

1. That all the bank statements of the paid cheques for the several departments, together with the cheques themselves, be sent direct by the banks to the Finance Department.

2. That a certain number of the officials of the Finance Department be employed solely in the checking and adjusting of these accounts, as well as of the letter of credit and Receiver General's accounts of that department. The banks should be instructed to render these statements and cheques daily, weekly or monthly, as the volume of business and importance of the various accounts demand.

3. That, as provided in section 30 of the Audit Act, a list of cheques, drawn by the various departments, giving numbers, dates and amounts be sent to the Finance Department at such periods within the month as may be required. When these statements and bank accounts are checked and adjusted, a list of outstanding cheques should be prepared. A letter of credit ledger should be kept, and such minor details arranged as may be found necessary for the proper conduct of the work.

4. After adjustment, the paid cheques, list of outstanding cheques and certificate of adjustment should be sent to the Auditor General, the correctness of which could be tested by him after comparison with the semi-monthly or monthly balances furnished him by the banks.

This system will prevent any person or persons connected with the issue of departmental cheques from covering up any fraud arising from collusion or neglect, such as issuing forged or raised cheques; or from manipulating the bank accounts for fraudulent purposes; or from the destruction of cheques or accounts for the purpose of removing the means of detection and conviction.

This system will not prevent forgery, but it will restrain the person disposed to fraud, for the reason that it provides such speedy means of detection.

The Commissioners also suggest that the official having charge of the checking of the bank accounts be authorized to examine the cheque books, cash books, and other books of the various departments having reference to the payment of accounts, banking and cash transactions generally, and report to the Treasury Board recommending such changes as he deems necessary for the proper safeguarding of money under the control of the various officials in the government service.

The Commissioners, passing from the letter of credit system, have now to make the following observations with regard to the cheques used in the Government service.

In view of the large number of cheques drawn by the several departments and by their outside officials, which, so far as the Commissioners have ascertained, would amount in the course of the year to 487,000 in number, the Commissioners are of the opinion that no measure of protection can be too good for the government to use. The suggestions they make are only to be regarded as rendering the manipulation of cheques more difficult, for no system yet devised affords absolute immunity from the cunning of the forger.

The Commissioners are of the opinion that the advice of the King's Printer, who has for a long time made a study of this subject, would be of material value in enabling the Government to determine the best measure of protection to be adopted. They, however, suggest that a uniform paper of a sensitive nature should be adopted with the words "Dominion of Canada" or other distinctive symbol as a water-mark, and that the use of the said water-mark, or of paper with such water-mark thereon for other than the purposes of the Government, be made a criminal offence. Such paper should

be used for both the inside and outside services. A water-mark or dandy roll is used in the manufacture of paper for postal notes.

That a uniform quality of ink of good standard, and a uniform style of cheque be adopted for use in all departments, the wording on the cheques to be varied only by the change in name of the department, &c. That the King's Printer be authorized to decline the issue of chemicals or of pencils for erasing ink marks.

That the accountants of the various departments be instructed not to allow any erasures in books or accounts kept in their branches, but that all corrections be made by ruling out the words or figures to be changed.

That where possible a perforator for perforating the exact amount be used to protect the cheques from alteration. Where time will not admit of the use of a perforator of this kind, others containing the words 'not over \$1,000' (or as the case may be) should be used. Where a large number of cheques are drawn at one time, as in the Post Office Department, where six or seven thousand are drawn during the first week of each quarter to pay postmasters, it may be difficult to put this into operation. It is understood that while it is deemed desirable, the Commissioners do not press the use of a perforator if in any way it would retard public business.

That a uniform system ought to be enforced in all the departments as to the numbering of cheques. At present in some departments the cheques have printed numbers, in other departments the numbers are written, while in others they are stamped with a numbering machine. That all cheques should be numbered consecutively in print, commencing at the beginning of each fiscal year at No. 1, all unused cheques to be destroyed in the presence of two officers. *Every blank cheque* should be accounted for, whether cancelled or issued. No unnumbered cheques should be allowed to exist, except in such departments where it is found necessary for facilitating public business, and then only with the consent of the Treasury Board under such regulations as may be provided. If a register of cheques issued is kept in consecutive numbers no stub or counterfoil is required.

The Commissioners find that in some of the smaller departments the accountant appears to do all the work connected with the cheques, from making them out to the checking of them with the bank return. This system should be varied as far as possible.

The Commissioners find in one or two departments that no substitute is provided to sign cheques, and they recommend in all such cases that an Order in Council be passed nominating an officer to sign in the absence of the signing official.

A covering letter or statement detailing the number of cheques inclosed should be sent with each remittance, and the cheques should not be sent out by the officer who writes them.

A record of such letters or statements should be kept in the department issuing them.

The Commissioners find, in the course of their examination of the several departments, that, while the receipts and drafts for all deposits made on account of the various services throughout the Dominion of Canada at the several branches of banks authorized to receive government funds are sent to the department having control of the particular service, it is noticeable that in some cases considerable time is allowed to elapse before such receipts and drafts are transmitted to the Receiver-General for the credit of the respective services and for collection from the various banks. This seems to be particularly the case with the Militia Department, where the Commissioners found that 37 receipts and drafts were then outstanding.

The Commissioners recommend that in future all persons having payments to make to the Militia Department be requested to send the deposit receipts and drafts to the Deputy Minister or Secretary of the Department, who shall transmit the same to the Accountant. The Accountant will then advise the Director of Stores, in case the deposit covers payment for stores, ammunition, &c., &c.; the Adjutant General, when the deposits are made for discharges from units of the permanent force; or what-

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ever branch of the department has charge of the service to which the deposits relate. With regard to the other departments, as only a small number of receipts and drafts were found to have been delayed in transmission, the Commissioners consider no observation need be made.

The Commissioners are of opinion that the foregoing suggestions will be sufficient to protect the public interest, but unless the audit is continuous and thereby effective, the public interest will still be liable to suffer.

The Commissioners, in conclusion, further recommend that, at as early a date as possible, steps be taken to have submitted to the Public Accounts Committee of the House of Commons the accounts of the several departments with a view to wiping off all uncollectable balances and bad debts, and for the revising of the balance sheet.

All of which is respectfully submitted,

J. M. COURTNEY.

GEO. BURN.

A. L. KENT.