

2005



A Status Report
of the
Auditor General of Canada
to the House of Commons

FEBRUARY



Office of the Auditor General of Canada

The February 2005 Report of the Auditor General of Canada comprises eight chapters and a Message from the Auditor General.

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my first Report of 2005 to the House of Commons, which is to be tabled in the House in accordance with the provisions of subsection 7(5) of the *Auditor General Act*.

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 15 February 2005

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A Message from
the Auditor General of Canada



Sheila Fraser, FCA
Auditor General of Canada

A Message from the Auditor General of Canada

I am pleased to present my third Status Report to the House of Commons.

One of Parliament's most important roles is to hold the federal government to account for its use of taxpayer dollars. To fulfill its role as watchdog over the public purse, Parliament needs objective, accurate information on how well the government is managing public funds.

The Office of the Auditor General is an independent, reliable source of such information. Since 1977, my Office has conducted performance audits that examine whether the government is managing its programs with due regard to economy, efficiency, and environmental impact and has measures in place to determine their effectiveness.

The information we provide to parliamentarians gives them a better basis for scrutinizing government operations and evaluating the progress of large-scale initiatives to improve governance. Our audits cover a wide range of topics and provide recommendations with the potential to promote positive, lasting change in the way the government functions.

After our audit reports are tabled in the House of Commons, my colleagues and I frequently appear before parliamentary committees—along with representatives of the departments we have audited—to discuss what we have reported. The Standing Committee on Public Accounts often asks departments and agencies to provide action plans for addressing our recommendations, and it holds them to those plans; occasionally, other standing committees do this as well.

In my view, this Status Report demonstrates that the government does act in response to our recommendations and, in fact, does change for the better. In four of the chapters that follow, we conclude that progress has been satisfactory. We describe the positive steps taken by the Canadian International Development Agency, Transport Canada, and the Canadian Nuclear Safety Commission to resolve issues we raised in previous audits. We also conclude that the government's efforts to modernize its management of human resources are on track.

Unfortunately, we cannot say that the other four areas we audited show satisfactory progress. Much work is still needed on several large-scale initiatives to improve government. Canadians need to see more progress in such critical areas as the governance of Crown corporations, the security of the government's information technology, the accountability of foundations, and the management of the government's financial information.

What has made the difference between the satisfactory and the unsatisfactory progress we report here? We found that it has been the scale and complexity of the change that must be managed and the level of co-operation needed across the government to achieve results. Apart from the modernizing of human resources management—still at a very early stage of

implementation—each area that showed satisfactory progress was narrowly defined and within the control of a single department or agency of the government. Managing the changes needed in the four other areas has been a greater challenge because the changes involve many departments and agencies, take longer to carry out, and demand managers' leadership and persistence to maintain the necessary momentum.

Satisfactory progress

Transport Canada—Overseeing the National Airports System

In 1992, Transport Canada began to transfer the management of major Canadian airports to not-for-profit airport authorities, while retaining ownership of the airports by granting 60-year leases. By 2003, the 26 airports included in the National Airports System had been transferred. Our audit of the system in 2000 found that Transport Canada did not know the financial impact of the airport transfers and had not yet defined its role as owner, landlord, and overseer of the airports in the National Airport System. It could not say whether airport authorities were adhering to the terms of their leases, and it was not overseeing their financial viability.

Since then, Transport Canada has made satisfactory progress in implementing the recommendations of our 2000 audit. It has almost concluded the National Airports Rent Policy Review, which will allow it to assess the financial impact of transferring airports. It has also clarified and assumed its role as owner, landlord, and overseer of the airports while establishing good working relations with airport authorities.

The Department has determined that airport authorities are complying with the provisions of their leases and maintaining the airport facilities in a condition at least as good as before the transfers. It now monitors annually the financial situation of the airport authorities and oversees the long-term viability of the National Airports System.

Canadian International Development Agency—Financial Compliance Audits and Managing Contracts and Contributions

The Canadian International Development Agency (CIDA) is responsible for managing some \$2.6 billion in international development assistance. In 1999 and 2000 audit reports we recommended that CIDA improve its process of awarding contracts and contribution agreements for aid projects. We also said it should document its reasons for deciding not to recover funds in certain cases.

Overall, CIDA has made satisfactory progress in responding to our recommendations. It has made headway in reducing its use of non-competitive agreements, monetizing commodities for deposit to counterpart funds, monitoring project risks, ensuring the sustainability of project benefits, and documenting its decisions on audits of contribution agreements.

However, while conducting our follow-up we became aware of additional weaknesses. For example, we found that although required by policy, CIDA officers rarely analyzed the value of in-kind contributions claimed by recipients or verified that no provision was made for profit. We also noted

that in many cases, CIDA released Canadian executing agencies from their obligation to repay amounts falling outside the terms of their agreements, which means that CIDA did not ensure that it paid only for those goods received and services rendered according to the terms of the agreements.

In the last five years, CIDA has sharply increased its use of grants to fund aid projects; we are concerned this could lead to its sacrificing too much control and oversight over how its funds are spent without having analyzed the impact on results.

Canadian Nuclear Safety Commission—Power Reactor Regulation

The Canadian Nuclear Safety Commission (CNSC) regulates the use of nuclear energy and materials to protect the health, safety, security, and environment of Canadians. This includes the licensing and regulation of nuclear power reactors, which we audited in 2000.

On the whole, the CNSC has made satisfactory progress in responding to our recommendations. It has adopted a consistent approach to compliance and enforcement within and across the divisions that plan and conduct compliance inspections of power reactors. It has developed a new scale to rate how well power reactor licensees meet its regulatory expectations, and it has issued key regulatory documents.

Progress has been slower than planned, however, on developing a formal, well-articulated risk-management approach to regulating nuclear power reactors. In response to our previous audit, the CNSC developed an action plan that it posted on its Web site and updated regularly. The action plan called for the establishment of a risk-based approach by the end of 2003. While the CNSC has adopted this approach in its regulating of nuclear substances and uranium mining and processing, it does not yet follow such an approach for power reactor regulation.

Modernization of Human Resources Management: Managing the Reforms

The legislative framework for human resources management in the federal public service is currently undergoing the most fundamental transformation since the mid-1960s. The new *Public Service Modernization Act*, passed in November 2003, is being phased in over several years, so its full impact will not be evident for some time. Given that it is still in the early stages, implementation is proceeding in an orderly way, and progress is satisfactory.

In my view, the government has laid a solid foundation for carrying out the modernization of human resources management. For the most part, roles and responsibilities have been clarified. However, the Treasury Board Secretariat needs to ensure that the activities of the three agencies that now play key parts of the employer role—the Treasury Board Secretariat, Canada School of Public Service, and Public Service Human Resources Management Agency—are better integrated and co-ordinated. In particular, the role of the new human resources management agency should be further clarified to define its

expected contribution to human resources governance and its relationship to the other stakeholders.

Some of the major organizational changes required by the new legislation have occurred quite smoothly, such as the transfer of certain functions from the Public Service Commission to the Treasury Board Secretariat and the creation of the new Canada School of Public Service. This is largely due to a strong project management process, which has received effective leadership from the deputy minister community.

If this wide-ranging and complex reform initiative is to be successful over the long term, the government will need to maintain its focus and momentum. This will be a challenge, given the many demands on the public service today. The government needs to clearly define the outcomes it expects from the reform of human resources management and then monitor and report on ongoing progress. It also needs to ensure that the full costs of this reform are monitored, controlled, and reported.

Better reporting will be critical in light of the five-year review of the legislation once it comes into effect. Parliamentary committee review of these reports would be a way to influence the nature, direction, and pace of change and also an opportunity to ensure that momentum is maintained and reforms actually take place.

Unsatisfactory progress

Governance of Crown Corporations

Crown corporations control and manage billions of dollars in public funds. It is therefore vital that they be governed well. In 2000, we expressed concern about the governance practices of Crown corporations and made several recommendations for improvement.

In recent years, high-profile failures among publicly traded corporations in North America have prompted many positive developments in corporate governance. Legislation in the United States (the *Sarbanes-Oxley Act*) and more stringent securities regulations in Canada have turned expectations for good corporate governance of publicly traded corporations into requirements. In our view, many of these changes can be adapted to the governance and accountability framework of Crown corporations.

Our follow-up audit examined what the government and Crown corporations have done to implement the recommendations we made five years ago. We found that the overall response has been unsatisfactory. Although individual Crown corporations have made improvements, progress in responding to most of our recommendations has not been as swift or as extensive as we had expected.

It took more than three years for the government to address some of our key 2000 recommendations by starting the Treasury Board Secretariat review of corporate governance in February 2004.

Board, chair, and CEO appointments are still taking too long, and terms are not adequately staggered. In addition, the responsibilities and expectations of the government regarding Crown corporations still need to be clarified.

The changes in the process for appointing directors of Crown corporations, announced in March 2004, have not yet been fully defined or implemented. These changes were put forward by the government to enhance transparency and increase Canadians' confidence that the best people are being appointed to public institutions. Since none of the government's recent appointments have followed the new process fully as of this writing, we could not assess its impact.

On an encouraging note, however, we observed fewer gaps in the collective skills and expertise of board members. We also found that the composition and operating practices of board audit committees had improved and that audit committees are operating more effectively than in 2000.

In my view, a range of private sector practices could usefully be emulated in Crown corporations. These include ensuring that the board plays a key role in its own renewal and in selecting the chair and CEO; strengthening the independence of boards and audit committees; requiring that the mandate and operations of the board be defined; strengthening corporate values and ethics practices; and improving the quality of reporting and disclosure.

While these practices are not yet expected of Crown corporations, the Treasury Board Secretariat informs us that it is considering them in the review of Crown corporation governance it is now conducting.

Information Technology Security

In our follow-up audit of information technology (IT) security in government, we noted some encouraging signs of improvement. The development of policies and standards has laid a sound foundation for a more secure IT environment in government. Lead agencies and departments are now more involved and committed.

Overall, however, the government has made unsatisfactory progress in strengthening IT security. Two and a half years after revising its Government Security Policy, it still has much work remaining to translate policies and standards into consistent, cost-effective practices that will result in more secure IT.

IT systems in departments and agencies continue to be vulnerable to breaches in security. The majority of departments do not meet the minimum standards of IT security. Vulnerability assessments conducted in departments and agencies over the last two years have revealed significant weaknesses. If these are exploited, the result could be serious damage to government information systems.

I am concerned that members of senior management are not aware of the risks to IT security in their departments and do not understand how breaches of IT security could affect their operations and the federal government's credibility.

Managing Government: Financial Information

The government continues advancing in its use of accrual financial information and improving the quality of the systems supporting that information. However, more work is needed if departments and agencies are to have better financial information for decision making. Better financial information would also improve financial accountability to Parliament—not just result in improved year-end accrual financial information for preparing the government’s summary financial statements. The Office of the Comptroller General of Canada needs to lead this initiative by aggressively advancing the use of accrual financial information and promoting the importance of good internal financial controls.

Departments and agencies must take stronger and swifter action to correct weaknesses in their internal financial controls. Integrated, comprehensive internal control systems have a significant role to play in ensuring that high-quality financial information is available for decision making.

I urge the government to finalize its study of accrual-based appropriations and budgeting at the department level and to move forward in this matter. Without direction and guidance, wider use of accrual financial information in decision making will be delayed still further.

I also encourage the Office of the Comptroller General to finalize a plan for resolving all remaining issues for the fair presentation of departmental and agency financial statements. This will be necessary if the government’s goal of having such financial statements audited within five years is to become a reality.

Accountability of Foundations

In 1997 the government introduced a new approach to achieving policy objectives—through the transfer of public funds to foundations, which are non-profit corporations that operate at arm’s length from government. At March 2004, more than \$9 billion had been paid to such foundations. These upfront payments are made many years before they are needed.

Given the magnitude of these transfers, I have repeatedly expressed concern about the governance and accountability of foundations and the government’s accounting for its payments to them.

Our performance audits in 1999 and 2002 found that accountability to Parliament had been placed unnecessarily at risk. The essential requirements for accountability to Parliament were not being met—namely, effective ministerial oversight, adequate provision for external audit, and credible reporting of results. We examined progress in these three areas following the 2003 and 2004 Budget plans, in which the government announced its commitment to improve the accountability of foundations.

Despite some changes for the better, progress overall has been unsatisfactory. Mechanisms for ministerial oversight are not adequate for the government to make adjustments in foundations where circumstances have changed

considerably. There is no provision requiring foundations to undergo performance audits that are reported to Parliament.

Reporting to Parliament and the public has shown some progress. The government is committed to better reporting in the corporate plans, summaries, and annual reports of foundations and in the Estimates documents of sponsoring departments. But the performance information that is provided is not sufficient for effective parliamentary scrutiny, and it needs to be improved.

Conclusion

The purpose of legislative auditing is not to point fingers and issue stern rebukes when problems occur in public sector management. Audits are intended to be learning tools to help management identify things that could be done better and to recommend specific improvements.

Cynics would have us believe that nothing ever comes of our recommendations to the government. In their view, once the Office's reports are made public and the hoopla dies down, the government returns to business as usual.

I beg to differ. The government does pay attention to our reports. And this Status Report bears this out. In four out of eight cases, departments and agencies made satisfactory progress in responding to our recommendations. We are heartened by their achievements and commend their dedication.

In the four cases of unsatisfactory progress, we recognize the complexity and difficulty of the sweeping changes across government that they entail. Nonetheless, these long-standing, challenging issues must be addressed with renewed vigour and with clear plans and strategies. Our audits have shown that success in these cases will need strong leadership and the ability to maintain focus and momentum over long periods of time. In the end, it will be Canadians who benefit from these vital efforts.

